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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 32

RECONSTRUCTION FINANCE CORPORATION,
PETITIONER

v.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The initial report and order of the Interstate Commerce Commission (R. 2153, 1258)[1] are reported in 239 I.C.C. 485, and its supplemental report and order (R. 1284, 1319) are reported in 240 I.C.C. 257. The opinion of the District Court (R. 1857) is reported in 36 F. Supp. 193. The opinion of the Circuit Court

[1] The full record in this case consists of the transcripts of the proceedings before the Interstate Commerce Commission, the District Court and the Court below, together with numerous exhibits, all of which have been certified and filed with this Court. In view of the voluminous character of the record, the parties have stipulated (R. 2151, 2275, 2280, 2288) for the printing of only selected portions thereof. Those portions have been consolidated into six volumes designated herein as "R".

of Appeals (R. 2318) is reported in 124 F. (2d) 754, and its supplemental opinion on motion to modify its original opinion (R. 2334) is as yet unreported.

JURISDICTION

The decrees of the Circuit Court of Appeals were entered December 4, 1941 (R. 2318-2324). A petition for modification of the opinion of the Circuit Court of Appeals was subsequently filed by H. C. Orton, et al., as a Protective Committee for the holders of Preferred Stock of Chicago, Milwaukee, St. Paul and Pacific Railroad Company, Debtor, and an answer to such petition filed by the Life Insurance Group and Mutual Savings Bank Group. By order dated January 12, 1942, accompanied by a supplemental opinion of the same date (R. 2334-2335) the Circuit Court of Appeals denied the motion. The petition for certiorari was filed February 28, 1942 and was granted on June 8, 1942.[2] The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, and Section 24(c) and 77 of the Bankruptcy Act.

QUESTION PRESENTED

On June 4, 1940 the Interstate Commerce Commission, in proceedings under Section 77 of the Bankruptcy Act, issued an order approving a plan of reor-

[2] Joint petitions for certiorari were filed by the Group of Institutional Investors (Life Insurance Group) and Mutual Savings Bank Group, and these petitions were also granted. Certain cross petitions were filed by various appellants below, but no action has yet been taken thereon by this Court.

ganization (R. 1319-1347) for Chicago, Milwaukee, St. Paul and Pacific Railroad Company, Debtor. The question presented is whether the findings and conclusions of the Interstate Commerce Commission were sufficient to support the allocation of the securities of the reorganized company among those found to be entitled to share therein, in the manner provided in the plan of reorganization.

STATUTE INVOLVED

The relevant portions of Section 77 of the Bankruptcy Act, 47 Stat. 1474, 11 U.S.C., Sec. 205, as amended, are set forth in Appendix A, *infra*, pp. 108-120.

STATEMENT

On June 29, 1935 the Chicago, Milwaukee, St. Paul and Pacific Railroad Company (hereinafter called the Debtor), which was the result of an earlier reorganization of its properties extending from 1925-1928,[3] filed

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[3] Various phases of these receivership proceedings were the subject of consideration by this Court in *United States* v. *Chicago, Milwaukee & St. Paul Railway Company*, 282 U.S. 311 (1931), by the Commission in *Investigation of Chicago, Milwaukee & St. Paul Railway Company*, 131 I.C.C. 615 (1928) (see R. 1721) and *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673 (1928) (see R. 1721-1722) and by a sub-committee of the Committee on Interstate Commerce of the United States Senate. See *Hearings before a Sub-Committee of the Committee on Interstate Commerce, United States Senate*, 75th Congress, 2nd Session, pursuant to S. Res. 71 (74th Congress), parts 16 and 17, pages 6775-7394; Sen. Rep. No. 25, parts 18-22, 76th Congress, 3rd Session.

its petition for reorganization (R. 2-42) under Section 77 of the Bankruptcy Act relating to railroad reorganizations (11 U.S.C., Sec. 205). At the time of filing its petition the Debtor operated a railroad system extending from Chicago to Seattle, Tacoma and other Puget Sound points, with lines extending to Kansas City, Missouri; Omaha, Nebraska; Rapid City, South Dakota; and numerous other points. The system included approximately 11,000 miles of road solely or jointly owned, or operated under lease or trackage rights, plus approximately 5,000 miles of main tracks, yard tracks and sidings, together with rolling stock, equipment, terminals and other facilities and properties. The leased lines include those of the Chicago, Terre Haute and Southeastern Railway Company, a coal line extending from Chicago Heights, Illinois. to points in southeastern Indiana.

PROCEEDINGS BEFORE THE COMMISSION

In accordance with the provisions of Section 77 hearings were held before the Commission with respect to the reorganization of the Debtor on August 5-7, 1935, June 16, 1937, February 1-4, 1938 and March 21-22, 1938, at which all parties were given an opportunity to be heard.

Without any attempt to summarize fully the more than 1,600 pages of evidence and 219 exhibits constituting the record before the Commission, it may be said that there was presented before the Commission a full statement of the properties, assets

and liabilities of the Debtor and its affiliated companies; their corporate and financial histories, including the prior receiverships of the Debtor's properties; the existing financial structure of the Debtor's system; detailed information as to the valuation for rate-making purposes, the cost records of the properties of the Debtor and its subsidiaries and other elements of value; studies and figures as to the traffic and revenue of the Debtor for past periods and at the then present time, together with studies of its prospective traffic and revenues; computations and estimates by several different witnesses as to the net income of the Debtor's system available for fixed charges in past periods, on the basis of the Debtor's then present earnings, and as anticipated for future years; evidence as to the maintenance condition of the Debtor's properties, past maintenance expenditures and the probable expenditures necessary for their future maintenance; computations, based upon a segregation formula, as to the income properly allocable to the various portions of the Debtor's system, and testimony as to the contributions to the system of various mortgage lines and other parts of the system; information as to the properties, history and earnings of the Terre Haute, the Terre Haute mortgages and lease and other aspects of the Terre Haute problem; and much additional evidence too extensive to be summarized here. Substantially all of the evidence, both by way of testimony and detailed exhibits, offered by any party was received by the Commission. In addition, the record

before the Commission included comprehensive reports relating to various aspects of the Debtor's properties and affairs prepared on the direction of the Commission pursuant to Section 77(c)(11) of the Bankruptcy Act by the Commission's Bureau of Finance, Bureau of Valuation, and Bureau of Accounts. The Commission likewise had before it the report of its own investigation of the Debtor's properties and their previous receiverships, particularly that of 1925-1928, in *Investigation of Chicago, Milwaukee & St. Paul Railway Company*, 131 I.C.C. 615 (1928).

Briefs were filed by all parties at the close of the hearings and on November 5, 1938, in conformity with the practice of the Commission, a proposed report on a plan of reorganization for the Debtor (R. 1162), prepared by one of the Commission's Examiners, was filed and served upon the parties. Exceptions and replies to exceptions to this proposed report, and briefs with respect thereto, were filed by various parties, followed by argument before the Commission. On February 12, 1940 the Commission issued its report and order (R. 2153, 1258) approving a plan of reorganization for the Debtor. Petitions for the modification of this plan were filed by various parties and on June 4, 1940 a supplemental report and order (R. 1284, 1319) were issued by the Commission modifying in some respects its earlier report and order and approving the plan of reorganization for the Debtor in its final form.

The claims against and interests in property of the Debtor dealt with in the Commission's plan, including

EXHIBIT "A".

REVISED APPENDIX:

C., M., St. P. & P. R. R. Co. Reorganization, F. D. 10882

Present Obligations and Stock				Approved Plan as modified						
	Principal Amount	Interest accrued to Dec. 31, 1938, and not authorized to be paid	Total	Undisturbed or Extended	First Mortgage Bonds	General Mortgage 4½% Bonds: Series A	General Mortgage 4½% Bonds: Series B convertible	5% Preferred Stock	Common Stock No-par Value shares
					(4% interest except Terre Haute bonds)				
Equipment obligations	$33,322,999	$	$33,322,999	$33,322,999	$	$	$		
					(100%)				
R. F. C. loans	12,920,463		12,920,463 (a)		$11,947,164				
Note to Cont. Ill. Nat. B'k. & Trust Company	1,184,000		1,184,000	1,184,000					
Terre Haute bonds:									
So. Ind. Ry. 4s, 1951	7,287,000		7,287,000		7,287,000)				
Bedford Belt Ry. 5s, 1938	250,000		250,000		250,000)				
T. H. first & ref. 5s, 1960	8,056,000		8,056,000		8,056,000)	See Note.			
T. H. income 5s, 1960	6,336,000		6,336,000		6,336,000)				
					(70%)	(30%)			
Mil. & Nor. R. R. bonds: First mtg. 4½s, 1939	2,117,000	103,204	2,220,204		1,554,143	666,061			
					(25%)	(35%)	(20%)	(20%)	
Consol. mtg. 4½s, 1939	5,072,000	247,260	5,319,260		1,329,815	1,861,741	1,063,852	1,063,852	
General Mtg. bonds, 1989:					(25%)	(35%)	(20%)	(20%)	
Series A, 4s	48,241,000	5,653,090	53,894,090		13,473,523	18,862,931	10,778,818	10,778,818	
Series B, 3½s	8,950,000	920,211	9,870,211		2,467,553	3,454,574	1,974,042	1,974,042	
Series C, 4½s	42,597,000	5,652,191	48,249,191		12,062,298	16,887,217	9,649,838	9,649,838	
Series E, 4½s	24,000,000	3,217,320	27,217,320		6,804,330	9,526,062	5,443,464	5,443,464	
Series F, 4¾s	15,000,000	2,137,381	17,137,381		4,284,345	5,998,083	3,427,476	3,427,476	
							(15%)	(60%)	(25%)
50-yr. mtg. 5s, 1975	106,395,096	20,835,706	127,230,802				19,084,621	76,338,481	318,077
Convert.-Adjust. mtg. 5s, 2000	182,873,693	79,550,055	262,423,748						1,749,492
									39,163(c)
								(75%)	(25%)
Gary first mtg. 5s, 1948	3,000,000	562,500	3,562,500					2,671,875	8,906¼
					5,000,000	(Assumed amount of new money bonds issued in reorganization. Interest assumed at 4%).			
Unsecured claims (9/30/37)	445,162		445,162						15,837(d)
Total debt	508,047,413	118,878,918	626,926,331						
Preferred stock	119,307,300			No equity					
Common stock, no-par value	1,174,060 shs.	(b)		No equity					
Totals, New Company	34,506,999				58,923,171	57,256,669	51,422,111	111,347,846	2,131,475¼
Terre Haute					21,929,000	(See Note)			

Note: These items, strictly not a part of the capital structure of the new company, are included here since, under the plan, the new company will assume obligation with respect to principal and interest of the four classes of Terre Haute bonds, if the terms thereof are modified as provided in the plan. Such modification includes the provision that the bonds will bear fixed interest at the rate of 2.75 percent and contingent interest at the rate of 1.5 percent per annum.

(a) Reflecting repayment of $290,000 January 3, 1939. Further reduced for purpose of the plan by crediting $973,299 cash in hands of first and refunding mtg. trustee December 29, 1938, leaving $11,947,164 to be discharged by issue of new securities.

(b) Not including capital stock of the Terre Haute. Of such stock, 1,259 shares are not owned by the Milwaukee.

(c) Additional common stock assigned on basis of free assets.

(d) Other additional common stock issued on the basis of free assets; to be issued to holders of unsecured claims as provided in the plan.

SUMMARY

	Principal Amount	Annual Charges
Equipment obligations, to be assumed; maturities to be rearranged in part	$ 33,322,999	$1,286,000
Bank note, undisturbed	1,184,000	23,680
First Mtg. bonds of new company	58,923,171	2,356,927
New Terre Haute bonds; portion representing fixed interest	15,350,300	603,047
Total fixed int. debt	108,780,470	4,269,654
Adds.—Betts. fund; mandatory payment		2,500,000
Gen. mtg. 4½% income bonds of new company	108,678,780	4,890,545
New Terre Haute bonds, portion representing contingent interest	6,578,700	328,935
Total system debt	224,037,950	
Sinking fund, approx.		543,391
Charges ahead of dividends		12,532,528
New 5% preferred stock	111,347,846	5,567,392
New no-par common stock, shown at $100 a share	213,147,525	
	548,533,321	

Percent of debt to total capitalization—40.8.

accrued interest to the effective date, January 1, 1939, the capital structure provided under the approved plan for the reorganized company and the distribution of the securities of the reorganized company among those found to be entitled to share therein are shown in graphic form in Exhibit "A" to the supplemental report of the Commission which, with certain minor corrections, is also annexed to the opinion of the District Court (R. 1317, 1899) and is reproduced opposite this page.

Under the approved plan, the maximum capitalization of the reorganized company was fixed at $548,533,321 divided into undisturbed obligations, first mortgage bonds, general mortgage income bonds, preferred stock, common stock and assumed Terre Haute mortgage bonds, as provided in detail in the plan. In its original report of February 12, 1940 the Commission after discussion of the record concluded that "we find that the equity of the holders of the debtor's preferred stock and its common stock has no value and the holders of claims in classes 24 and 25, therefore, are not entitled to participate in the plan." (R. 2260) This finding was reaffirmed in the Commission's supplemental report of June 4, 1940 (R. 1312). The securities of the reorganized company were therefore distributed among the creditors of the Debtor in the manner and proportions shown on the chart reproduced herewith. Provision was also made under the plan for a mandatory additions and betterments fund of $2,500,000 per year payable out of avail-

able net income immediately after fixed charges, and for an offer to the Terre Haute bondholders of certain modifications of the bonds and lease with alternative provision for the rejection of the Terre Haute lease.

As has been noted, the Commission's plan is embodied in its supplemental order of June 4, 1940 (R. 1319-1347), and represents a modification, after petition and hearing, of the plan initially approved by the Commission's order of February 12, 1940 (R. 1258-1283). The latter order was directly based upon the Commission's report of the same date (R. 2153-2269), described by the Commission in its order as "containing its findings of fact, its conclusions thereon, and a full statement for the reasons for its conclusions, which report is hereby referred to and made a part hereof" (R. 1258). Similar recital is made in the Commission's supplemental order of June 4, 1940 with respect to its supplemental report of the same date (R. 1319).

Since the Circuit Court of Appeals appears to have upheld the conclusions of the Commission with regard to the permissible maximum capitalization of the reorganized company and the division of that capitalization into various types of new securities, the reasons and findings of the Commission upon which its conclusions in this connection were based are not considered in detail herein. Since, however, although expressly approving (R. 2297, 2313) the additions and betterments fund provided for under the plan, the Circuit Court

of Appeals suggested that additional findings were necessary in this connection, the actual findings of the Commission with respect to the additions and betterments fund are discussed in detail in Point II, *infra*, pp. 39-44. With regard to the allocation of the securities of the reorganized company, no question appears to be raised regarding certain claims left undisturbed under the plan or with regard to the treatment of the claim of Reconstruction Finance Corporation; and the Circuit Court of Appeals expressly upheld as adequate the finding of the Commission that the claims of the Debtor's preferred and common stockholders had no value. On other problems of allocation, however, and with respect to the proposals made to the Terre Haute bondholders, the Circuit Court of Appeals considered the findings of the Commission to be insufficient. The findings and conclusions of the Commission with respect to these matters are, therefore, discussed in detail in Point III, *infra*, pp. 44-83, and Point IV, *infra*, pp. 83-104.

PROCEEDINGS BEFORE THE DISTRICT COURT

The plan of reorganization thus approved by the Commission was certified by it to the District Court on June 14, 1940 (R. 1349). On June 21, 1940 the District Court entered its order (R. 1348-1350) fixing the time within which objections to the plan and claims for equitable treatment might be filed, and setting a date for hearing thereon. Objections to the plan were filed by various parties, and statements

of position in support of the plan filed by other parties (R. 1352-1485). On September 4-6, 1940 a hearing was held before the District Court (R. 1491-1794) at which testimony was presented regarding the recent earnings of the Debtor and its probable future earnings, the valuation of its properties under Section 19a of the Interstate Commeree Act for rate-making purposes, the expenses of maintenance of the Debtor's properties and possible savings through coordinations and abandonments, various matters relating to the Terre Haute and other particular mortgage lines, and other subjects. Following such hearing the matter was fully argued before the District Court.

Thereafter on October 21, 1940 the District Court rendered its opinion (R. 1857-1899) stating its approval, with certain minor clarifications, of the plan of reorganization approved and certified to it by the Commission. On November 13, 1940 the District Court entered its decree (R. 1978-1992) incorporating its findings of fact and conclusions of law and specifically approving (R. 1989) the plan of reorganization. In its decree the District Court specifically concluded, in accordance with the statutory requirements (Sec. 77(e), 11 U.S.C., Sec. 205), that "the Modified Plan conforms in all respects to the requirements of Section 77, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders and conforms to the law of the land regarding the participation of the

various classes of creditors and stockholders, and, with the corrections and clarifications approved under Finding of Fact 11, is approved." (R. 1986) The District Court also found that the equity of the Debtor's preferred and common stockholders had no value (R. 1982), and affirmed the finding of the Commission to the same effect (R. 1986, 1991).

PROCEEDINGS BEFORE THE CIRCUIT COURT OF APPEALS

On inconsistent and widely divergent grounds, appeals were taken by various parties to the Circuit Court of Appeals for the Seventh Circuit from the decree of the District Court approving the plan. On the *ex parte* application of counsel for the Debtor, the Circuit Court of Appeals (R. 2274) ordered that the submission of the plan of reorganization by the Commission to the creditors be stayed until the determination of the appeal of the Debtor; and the Circuit Court of Appeals rejected two subsequent applications of certain appellees, including Reconstruction Finance Corporation, that this order be vacated and the stay dissolved (R. 2287, 2296).

On December 4, 1941 the Circuit Court of Appeals rendered its decision reversing the District Court's order of approval. In its opinion the Circuit Court of Appeals stated among other things "We are well satisfied that the evidence supports the finding of the Commission approved by the District Court 'that the equity of the holders of the debtor's preferred stock and its common stock has no value.' * * * The plan as

such, ignoring the absence of findings, has support in the evidence. It violates no requirements (save findings) announced in the Consolidated Rock Products case." (R. 2311, 2312; 124 F. (2d) at 764). Nevertheless, on the ground that the findings of the Commission were insufficient to support the allocation of the securities of the reorganized company among those entitled to share therein, in the manner provided in the plan of reorganization approved by the Commission and the District Court, the Circuit Court of Appeals by separate decrees entered in each of the appeals on December 4, 1941 reversed and remanded the cause to the District Court with directions to set aside the District Court's order of approval and "to remand the case to the I. C. C. for the making of findings, and, if necessary, the taking of additional evidence, that additional findings may be made, as indicated in the opinion of this Court filed herein" (R. 2318-2324).

In a supplemental opinion on motion to modify its original opinion by eliminating therefrom the paragraphs indicating that the findings of the Commission with respect to the lack of equity in the preferred and common stockholders were adequate the Circuit Court of Appeals referred to "the failure of the Commission to make necessary findings of value so as to allocate the new securities amongst existing bondholders and creditors" (R. 2334). It stated, however, that "the finding of the I. C. C. as to absence of value of old common and preferred stock, is specific, definite and certain, and fully meets the rule which requires finding on

values of assets," and in addition that the evidence supported this finding (R. 2334, 2335).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the findings and conclusions of the Interstate Commerce Commission were insufficient to support the allocation of the securities of the reorganized company among those found to be entitled to share therein, in the manner provided in the plan of reorganization approved by the Commission and the District Court.

2. In failing to affirm the order and decree of the District Court approving the plan of reorganization for the Debtor approved and certified to it by the Commission.

SUMMARY OF ARGUMENT

1. Whether the decision of the court below requires simply that the Commission's conclusions and reasons be labeled as findings, or requires dollar valuations as a necessity in connection with all security allocations, it imposes requirements not found in Section 77 or in the applicable decisions of this Court. Section 77(d), conforming to the general statutory requirements with respect to action by the Commission, provides broadly that in its report "the Commission shall state fully the reasons for its conclusions," and there are no requirements of formalism in this connection.

Universal dollar valuations are unnecessary and impracticable, and would cloak with delusive exactness

the elements of judgment involved. Thus, where dominant weight is given to earning capacity, stockholders may be excluded upon a determination that their equity is without value. Similarly, it is submitted, where contributions of different mortgage divisions to the earning power of the total enterprises are shown, the new securities may be distributed essentially on the basis of such contributions without attempting the intermediate formality of dollar valuations. This procedure is especially appropriate in the reorganization of a railroad with a complex capital structure, where the concept of dollar value is at best an artificial one, and where differences in the source and stability of the earnings capitalized, differences in the relative contribution of particular mortgage divisions to the enterprise at various earnings levels, and other controversies, must all enter into the Commission's formulation of the plan.

In the present case the Commission, upon a full and complete record, has rendered a detailed report and supplemental report, and has specifically found, in accordance with the statutory requirement, that the plan approved by it is fair and equitable and otherwise complies with the requirements of subsections (b) and (e) of Section 77, and will be compatible with the public interest. These findings were directly approved by the District Court. The Circuit Court of Appeals, moreover, found support in the Commission's reports and findings for substantially all the features of the plan which the court discussed; but it conceived that

Consolidated Rock Products Co. v. *DuBois*, 312 U.S. 510 (1941), required a remand to the Commission for additional formal findings. This, we submit, was a misconstruction of that case, in which the difficulty was not the form of the findings made but the lack of essential evidence to sustain the plan. In numerous cases the District Courts have approved plans based on reports and orders of the Commission substantially similar to those in the present case.

2. The Commission's provision for an additions and betterments fund is adequately supported by its findings and conclusions, which explain the necessity for the fund and the amount deemed proper. The court below recognized that such support was contained in the evidence, and expressed strong approval of the provision.

3. The allocation of new securities is adequately supported by the findings and conclusions of the Commission, which exhibit a comprehensive analysis of the claims and security of each class of creditors. The Commission first determined the new securities available for allocation, in the light of the maximum permissible capitalization of the reorganized company. In allocating these new securities the Commission carefully considered all relevant data, including the character of the various liens, the earnings, properties and traffic of the respective divisions upon which the numerous bond issues constitute mortgages, and their contribution to the earnings of the system. With regard to substantially all such questions of allocation

the court below made clear its opinion that the Commission's allocation was supported by the record, apart from the requirement of additional formal findings which it felt constrained to impose.

4. The provisions of the plan regarding the Terre Haute bonds and lease are adequately supported by the findings and conclusions of the Commission. Although the Commission considered that the continuance upon proper terms of the relationship between the Debtor and the Terre Haute was desirable, it found that the Terre Haute mortgages could not be assumed and the lease affirmed in unmodified form without inequitable sacrifices on the part of the other interested parties. Under these circumstances the Commission's plan provides for a fair and reasonable offer to the Terre Haute bondholders, to become effective on acceptance by substantially all of such bondholders. The alternative remedy of disaffirmance of the Terre Haute lease, though necessarily provided as a contingency in the plan, may never become effective. Even if such a necessity should arise, the provisions with respect to the rejection of the Terre Haute lease or, more exactly, the refusal of the reorganized company to accept it as part of the properties to be acquired under the plan, are fully valid and within the powers of the Commission and the District Court.

5. Under the circumstances of the present case, the issues in controversy should be definitively disposed of by this Court by an affirmance of the decree of the District Court.

ARGUMENT

INTRODUCTORY STATEMENT

In view of the fact that the present case is one of the first concerning plans of reorganization under Section 77 to be considered by this Court, we have felt that it would be helpful to the Court to present at the outset a brief statement of the historical and statutory background. Moreover, while the Circuit Court of Appeals desired additional findings by the Commission, it is difficult to ascertain from its opinion exactly what further findings it considered necessary. We accordingly preface our argument with brief introductory statements on these matters.

A. The Historical and Statutory Background

Section 77 of the Bankruptcy Act, dealing with railroad reorganizations, was enacted in order to remedy a long series of abuses in prior equity receivership proceedings relating to railroads, which had resulted in unsound capital structures, excessive allowances of fees, and lack of consideration of the public interest. These abuses were brought particularly to public attention by the unjustifiable capitalization perpetuated in the last previous reorganization of the Debtor's properties, extending from 1925 to 1928, and by the successful effort of counsel in *United States* v. *Chicago, Milwaukee & St. Paul Railway Company*, 282 U.S. 311 (1931), to avoid the exercise of supervisory power by the Interstate Commerce Commission over allegedly excessive fees charged in that case. In enacting Section 77 Congress therefore had in mind

the introduction in the public interest of an administrative agency in railroad reorganizations, and the strengthening of the power of that agency to deal with the abuses which had previously existed.

The Interstate Commerce Commission was utilized as the appropriate administrative tribunal because of its specialized knowledge of railroad problems and its long experience in the field. Indeed, when Section 77 was under consideration there was a substantial body of opinion in favor of entirely withdrawing control of railroad reorganizations from the courts and lodging such control with the Interstate Commerce Commission. This was recognized by this Court in *Palmer* v. *Massachusetts*, 308 U.S. 79, 86-87 (1939), in which the Court stated:

> "Until the amendment of March 3, 1933, railroads were outside the Bankruptcy Act. But the long history of federal railroad receiverships, with the conflicts they frequently engendered between the federal courts and the public, left an enduring conviction that a railroad was not like an ordinary insolvent estate. Also an insolvent railroad, it was realized, required the oversight of agencies specially charged with the public interest represented by the transportation system. Indeed, when, in the depth of the depression, legislation was deemed urgent to meet the grave crisis confronting the railroads, there was a strong sentiment in Congress to withdraw from the courts control over insolvent railroads and lodge it with the Interstate Commerce Commission. Congress stopped short of this remedy. But the whole scheme of §77 leaves

no doubt that Congress did not mean to grant to the district courts the same scope as to bankrupt roads that they may have in dealing with other bankrupt estates.

"The judicial process in bankruptcy proceedings under §77 is, as it were, brigaded with the administrative process of the Commission. From the requirement of ratification by the Commission of the trustees appointed by the court to the Commission's approval of the court's plan of reorganization the authority of the court is intertwined with that of the Commission."

With regard to plans of reorganization, the debtor's plan is required to be filed simultaneously with the Court and the Commission. Other plans may be filed by the trustee, or by specified percentages of creditors and stockholders, or by any party in interest with the consent of the Commission. If a plan filed with the Commission is considered by it to be *prima facie* impracticable, it receives no further consideration. Except in this event, public hearings on the proposed plan of reorganization are held before the Commission at which opportunity is given to any interested party to be heard and following which the Commission renders a report and order approving a plan (which may be different from any proposed in the proceedings) which will in its opinion meet with the requirements of subsections (b) and (e) of Section 77 and will be compatible with the public interest.

Sub-section (b), describing broadly what the plan of reorganization may contain, authorizes among

other things provisions modifying or altering the rights of creditors or stockholders, requires that the plan shall provide for fixed charges in such an amount that after due consideration of the probable prospective earnings of the property in the light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for their payment, requires the provision of adequate means for the execution of the plan, which may among other things include the sale of the property of the debtor at a fair upset price or the distribution of the debtor's assets or the proceeds derived from their sale among those having an interest therein, and authorizes also the inclusion in the plan of any other appropriate provisions not inconsistent with Section 77.

In finding that the plan meets the requirements of sub-section (e) the Commission is required to find that it "is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders."[4] Sub-section (e) also provides that if it shall be necessary to determine the value of any property for any purpose under Section 77, such value

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[4] In addition, sub-section (e) contains certain requirements as to the expenses and costs of administration of the proceedings, and regarding the provision made in the plan for claims of the United States.

shall be determined by the Commission in the manner there provided. Under the same sub-section the Commission is authorized to find that the interests of any class of creditors or stockholders are not adversely and materially affected by the plan, or (as alternatives to a specific finding of insolvency) that the equity or interests of such class of creditors or stockholders have no value, or that the plan provides for the payment to such creditors or stockholders of an amount not less than the value of their equity or interests. If any such finding be affirmed by the court, as hereinafter described, submission of the plan to such class of creditors or stockholders for acceptance or rejection is not to be required. In addition to the foregoing findings under sub-sections (b) and (c) the Commission, as has been pointed out, is required to find that the plan approved by it "will be compatible with the public interest" (Sec. 77 (d)).

When the plan so approved by the Commission is certified to the court objections and claims for equitable treatment may be filed by all parties in interest and a hearing, as was done in the present case, is to be held thereon. Following such hearing the court is to approve the plan, if satisfied that it meets the requirements next to be described. If the court for any reason should disapprove the plan, it is not authorized to make changes or modifications therein, but has as its only alternatives the reference of the proceedings back to the Commission or the dismissal of the proceedings.

In approving the plan certified to it by the Commission the Court is required to find that it complies with

the provisions of sub-section (b) above referred to and "is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders."[5] No provision is made, it will be noted, for a finding by the court that the plan "will be compatible with the public interest"; nor is the court, as distinguished from the Commission, specifically authorized to pass upon the valuation of the property of the Debtor for reorganization purposes. In the event of findings by the Commission that a particular class of creditors or stockholders is not materially adversely affected by the plan, or that the equity or interests of such creditors or stockholders is without value, the statute provides that if such determination is "affirmed" by the court submission of the plan to such creditors or stockholders is not required.

B. The Opinion of the Circuit Court of Appeals

While the Circuit Court of Appeals reversed with instructions that the Commission be directed to make additional findings "as indicated in the opinion of this Court filed herein" (R. 2318-2324), it is difficult to ascertain from the opinion of the Circuit Court of

[5] The findings with reference to the expenses and allowances involved in the proceeding, and with respect to provision for the claims of the United States, are applicable to the court as well as to the Commission.

Appeals (R. 2314-2316) precisely what its requirements were.

Obviously, the court did not consider the record itself to be incomplete or inadequate, for it refers to "the full and complete story found in the report of the I. C. C., * * * and in the decision of Judge Igoe of the District Court" (R. 2298, 2299). Nor did the Court intend to hold that the plan was not supported by the evidence, for on the contrary it expressly stated that

> ". . . the fact situation permits of a plan such as the Commission formulated and approved. The plan as such, ignoring the absence of findings, has support in the evidence. It violates no requirements (save findings) announced in the Consolidated Rock Products case." (R. 2312; 124 F.(2d) at 764)

This statement was reiterated by the court with regard to various specific issues. Thus as to the additions and betterments fund provided for under the plan, although requesting additional findings "which support both the allowance and the amount of the allowance" the Circuit Court of Appeals nevertheless stated "that there is evidence which would amply warrant an allowance for such an item, and also the amount adopted by the Commission." (R. 2313) With regard to the General Mortgage Bonds the court similarly stated that "we are unable to say the evidence fails to establish the fairness of the plan so far as these bonds are concerned" (R. 2312) and as to the 50-year Mortgage Bonds (5's of 75) that these bond holders "have, we think, no legitimate complaint." (R.

2312). With regard to the allocations made under the plan to other bonds, the court observed that ". . . in our opinion there is evidence in the record to support the plan as proposed, but it cannot receive final approval until and unless there are findings made upon such evidence, and then the parties interested may have the right to review both the sufficiency of the findings to support the plan and the existence of evidence to support the findings." (R. 2314)

Nevertheless, on the ground that such action was required by the decision of this Court in *Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 510 (1941), the Circuit Court of Appeals held that the decision of the District Court must be reversed and the plan returned to the Commission for the making of findings additional to those contained in the Commission's reports (R. 2314-2316; 124 F.(2d) at 766).

What the Circuit Court of Appeals requires the Commission to do, in the light both of the court's reiterated statement that the record and the evidence are sufficient to support the approved plan, and of what the Commission has actually done as hereinafter discussed in more detail, is disconcertingly obscure. There is some suggestion that had the Commission specifically designated its various conclusions as findings this might have been sufficient, although this interpretation appears to be negatived by another statement of the court. There is also some implication that findings of dollar values must be made in connection with all allocations, whether or not the allocation is controverted and whether or not an ade-

quate basis for such allocation appears from the record without a dollar valuation.

The latter interpretation of the court's views is somewhat strengthened by the Court's discussion of the decision of this Court in *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510 (1941), to which the Circuit Court of Appeals refers as holding among other things that:

> "(d) There must be an approximate ascertainment of the value of the respective assets where different liens cover different properties;
>
> * * * * *
>
> "(j) Findings must be made on all vital issues, controverted and uncontroverted, and must include values of properties separately considered and also of Debtor's property as a whole. Findings must cover values of liens to be surrendered and values of securities given in exchange. They should specifically cover the ultimate (not evidentiary facts) facts upon which the values are based. They must show that fixed interest charges are included and show that values are based on income-producing factors." (R. 2309; 124 F. (2d) at 763)

Some additional light on the nature of the Circuit Court of Appeals' objections to the Commission's action in the present case may also be found in its subsequent decision in *In re Chicago & North Western Railway Company*, 126 F. (2d) 351 (C. C. A. 7th, 1942), in which it affirmed decrees of the same District Court approving and confirming a plan of reorganization for the Chicago and North Western

In addition to referring to the large vote of the Chicago and North Western bondholders in favor of that plan, the court stated with respect to the question of additional findings upon which it had relied in the present case:

> "Nor is there any jurisdictional question involved.
>
> "* * * The objection we are dealing with,—a failure of the findings of the I. C. C. to be sufficiently specific,—presents a procedural question. True, in many instances, this procedural question looms large and may be of controlling importance. Nevertheless, it is not jurisdictional in character. We are satisfied that different facts and a different law, under which the reorganization of railroads is authorized, distinguish this case from the Consolidated Rock Products case.
>
> "Confronted, then, by a situation which involves neither jurisdictional nor property right objections, we have approached, considered, and disposed of the findings requirement from four angles:
>
> "(a) The effect of waiver by a large percentage of bondholders upon the procedural requirement of specific findings.
>
> "(b) The completeness of the evidence on the specific issue whereon findings could and should have been made.
>
> "(c) The conclusive nature of other findings which make coverage by the missing specific findings less important.
>
> "(d) The persuasive effect of facts shown by the record and reduced to findings by the

I. C. C., which strongly support the plan submitted and approved by the District Court and the creditors." (126 F. (2d) at 368-369)

I

UNDER SECTION 77 THE INTERSTATE COMMERCE COMMISSION IS REQUIRED ONLY TO STATE FULLY ITS CONCLUSIONS AND THE REASONS THEREFOR, AND A REQUIREMENT OF UNIVERSAL DOLLAR VALUATIONS WOULD BE UNNECESSARY AND IMPRACTICABLE

Whether considered as requiring simply that the reasons and conclusions of the Commission be labeled as "findings," or as demanding dollar valuations in connection with all security allocations regardless of practical possibility or the necessity therefor, the decision of the Circuit Court of Appeals, it is submitted, imposes requirements not found in the decision of this Court in *Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 510 (1941), upon which the Circuit Court of Appeals relied, or in any principle of law applicable to railroad reorganizations under Section 77. On the contrary, the Consolidated Rock Products decision and the applicable principles of law require simply that valuations should be made in such instances and to such extent as the practical necessities of the particular case may require. Impracticable formality in the statement of the Commission's conclusions in this connection is not required.

Section 77 contains no requirement that findings shall be made by the Commission on all matters, but on the contrary provides broadly that in its report

"the Commission shall state fully the reasons for its conclusions" (Sec. 77(d)). This is in accordance with the general requirements for action by the Commission. Prior to 1906 the Commission was required to make findings of fact in its decisions, but this having proved an impracticable administrative requirement, Section 14 of the Interstate Commerce Act (49 U. S. C. § 14) now requires only, except in cases where damages are awarded,* that the Commission shall file a written report stating "the conclusions of the Commission, together with its decision."

As to the necessity of findings by the Commission this Court stated in *United States* v. *Louisiana*, 290 U.S. 70, 80 (1933), a rate case, that "There are no formal requirements for the findings to be made by the Commission in this type of case . . ." And while not commending the form of the particular report, this Court further held that:

> ". . . the report, read as a whole, sufficiently expresses the conclusion of the Commission, based upon supporting data, including estimates of experienced railroad traffic men, to which the

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* Even in damage cases impractical formality in the Commission's findings is not required. Thus in *Meeker & Co.* v. *Lehigh Valley R.R.*, 236 U.S. 412 (1915) this Court said of a report of the Commission: "True, the findings in the original report are interwoven with other matter and are not expressed in the terms which courts generally employ in special findings of fact, but there is no difficulty in separating the findings from the other matter or in fully understanding them, and particularly is this true when the two reports are read together, as they should be." (236 U.S. at 428) See also *Mills* v. *Lehigh Valley R.R.*, 238 U.S. 473, 481 (1915).

> report refers, that the probability of increased revenue was sufficiently great to make the increase of rates a reasonable exercise of sound managerial judgment. This, we think, meets the requirements of the statute." (290 U.S. at 80)

Similarly, in *Florida* v. *United States,* 292 U.S. 1 (1934), it was held:

> "The requirement of essential findings as to revenues did not demand an impracticable exactness. Losses through inadequate rates could be shown satisfactorily even though proof of the precise extent of such losses was not available. Reasonable determinations were required and these were made." (292 U.S. at 9)

This lack of necessity for any formal findings by the Commission has been repeatedly reiterated in the decisions of this Court. *Beaumont, S. L. & W. Ry. Co.* v. *United States,* 282 U.S. 74 (1930); *Florida* v. *United States,* 282 U. S. 194 (1931); *United States* v. *Baltimore and Ohio Railroad Co.,* 293 U.S. 454 (1935).[7]

In the Baltimore and Ohio case this Court pointed out that "§ 14(1) does not remove the necessity of making, where orders are subject to judicial review, quasi-jurisdictional findings essential to their constitutional or statutory validity." (293 U. S. at 465) This underlying qualification, however, is clearly

[7] To the same effect are the cases in the lower courts. *Visceglia* v. *United States,* 24 F. Supp. 355 (D.C.S.D.N.Y., 1938); *Quanah, A. & P. Ry. Co.* v. *United States,* 28 F. Supp. 916 (D.C.N.D. Texas, 1939).

without application to the present case, and the Circuit Court of Appeals itself has pointed out that its objection involves "neither jurisdictional nor property right objections," but presents only "a procedural question." *In re Chicago and North Western Railway Co.*, 126 F. (2d) 351, 368, 369 (C.C.A. 7th, 1942) quoted *supra*, p. 26. The Commission has rendered a lengthy report and supplemental report (R. 2153-2269, 1284-1317), in which, as we shall later show in more detail, it has "stated fully the reasons for its conclusions" on all matters here in question. The statutory provisions do not require, either as a jurisdictional matter or otherwise, that findings of value be made in all circumstances, but only "if it shall be necessary to determine the value of any property for any purpose under this section" (Sec. 77(e), last paragraph), and as will be demonstrated below all necessary findings were made by the Commission in this connection unless for some reason findings of dollar valuation are required under all circumstances. Based upon its reports, the Commission approved the present plan of reorganization for the Debtor and specifically found in accordance with the statutory requirement (Sec. 77(d)), that such plan was fair and equitable and otherwise complied with the requirements of sub-sections (b) and (e) of Section 77, and would be compatible with the public interest.

The contention that findings of dollar valuation on all questions of allocation, whether controverted or un-

controverted, are for some reason necessary, is clearly untenable. It is understood, of course, that the findings and conclusions of the Commission with respect to the interests and claims among which allocation of new securities is to be made, and with respect to the allocation itself, must be adequate for a fair and equitable allocation, and to enable the District Court, when the plan is certified to it, to determine whether the statutory standard has been applied. It is submitted, however, that an insistence upon universal dollar valuations in this connection is not only unnecessary but impracticable, and indeed that such valuations would in many circumstances tend to complicate rather than simplify the problems involved. That such valuations are not universally necessary has been recognized by the Circuit Court of Appeals itself which expressly and properly (*In re 620 Church St. Corp.*, 299 U.S. 24 (1936)) upheld as adequate the findings of the Commission that the equity of the Debtor's preferred and common stockholders was without value. Similar situations may well exist as between senior and junior creditors. Conversely, where a senior issue is fully satisfied, and the junior issue has received all that remains after such satisfaction, is it not unnecessary to place a dollar valuation upon the property or securities received by the junior issue? And where the contributions of different mortgage divisions to the earning power of the total enterprise are clearly shown, may not the new securities, in the application of the

determination of this Court in *Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 510, 526 (1941) that "the criterion of earning capacity . . . is the essential one," be distributed essentially on the basis of such contributions without attempting the intermediate formality of a dollar valuation?

This is not to say that dollar valuations, where it is practicable to make them, may not be desirable or helpful under some circumstances. On the other hand, differences in the source and stability of the earnings capitalized, differences in the relative contribution of particular mortgage divisions to the enterprise at various earnings levels, controversies over the rate of capitalization to be applied and other circumstances may vitiate attempted dollar valuations, particularly of parts of a large railroad system. In effect, such purported valuations may well add unnecessary complications rather than constitute a help toward the solution of the problem of allocating the securities of the reorganized company. This is particularly applicable to railroads, as to which this Court has expressly recognized that "* * * railroads, unlike farms and city lots and stocks and bonds, are not objects of exchange. The very notion of a 'full cash value' for a railroad is in many respects artificial. See 1 Bonbright, *The Valuation of Property*, pp. 511-632. Whatever may be the pretenses of exactitude in determining such a 'value,' to claim for it 'scientific' validity, is to employ the term in its

loosest sense." *Nashville, Chattanooga & St. Louis Ry* v. *Browning*, 310 U.S. 362, 370 (1940)* As stated in a recent commentary, "Procedural requirements which may not be insuperable in a simple Section 77B or Chapter X case may be fatal in a railroad reorganization proceeding. The structure of a debtor in the former may differ from that of a railroad system as much as a pre-fabricated one-room house differs from a Gothic cathedral." See Bourne, *Findings of "Value" in Railroad Reorganizations*, 51 Yale L.J. 1057, 1066 (1942).

Emphasizing the practicalities of administrative procedure "this Court has recognized that bodies like the Interstate Commerce Commission, into whose mould Congress has cast more recent administrative agencies, 'should not be too narrowly constrained by technical rules as to the admissibility of proof,' *Interstate Commerce Commission* v. *Baird*, 194 U.S. 25, 44, should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties." *Federal Com-*

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* "The ascertainment of the value of a railway system is not a matter of arithmetical calculations and is not governed by any fixed and definite rule. Facts of great variety and number, estimates that are exact and those that are approximations, forecasts based on probabilities and contingencies have bearing and properly may be taken into account to guide judgment in determining what is the money equivalent—the actual value—of the property." *Rowley* v. *Chicago & N. W. Ry. Co.*, 293 U.S. 102, 109 (1934).

munications Commission v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 143 (1940). Among the examples of this realistic approach by the Court are *New England Divisions Case*, 261 U.S. 181 (1923); *United States* v. *Louisiana*, 290 U.S. 70 (1933); *Florida* v. *United States*, 292 U.S. 1 (1934). "It cannot be supposed," as this Court pointed out in *United States* v. *Louisiana*, 290 U.S. 70, 76 (1933), "that Congress, in placing this duty on the Commission, intended, in the absence of some express provision compelling it, that the Commission should follow a procedure which would preclude its acting effectively, if at all."

Accordingly, it is submitted that the principles of law applicable to railroad reorganizations under Section 77 of the Bankruptcy Act do not require that the determinations of the Commission relating to value and the allocation of securities should be stated in some formalistic manner, or that dollar valuations should be made by the Commission under all circumstances. Valuations should be made in such instances and to such extent as the practical necessities of the particular case may require, and there is nothing in the statutory provisions or the requirements of due process which demands more.

The decision of this Court in *Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 510 (1941), contains nothing to the contrary and indeed supports the conclusions just stated. The difficulty in the Consolidated Rock Products case was not the form of the

opinion of the District Court approving the plan, but rather the absence of the essential evidence required to sustain it. In the present case, as the Circuit Court of Appeals recognized, "the full and complete story" (R. 2299) is found in the record and appears in the reports of the Commission, and the evidence of record supports the plan formulated and approved by the Commission (R. 2312, 2314). Both in determining the aggregate capitalization of the reorganized company and in allocating the new securities the Commission, recognizing the principle later definitely established by this Court in the Consolidated Rock Products case, gave dominant weight to the earning capacity of the system and of its mortgage divisions. In allocating on this fundamental basis the Commission, as will be later demonstrated in more detail, made and applied all necessary determinations of value required by the Consolidated Rock Products decision without the necessity of making in all cases valuations expressed in dollars and cents. And the Circuit Court of Appeals appears now itself to have recognized the unsoundness of its original reliance upon the Consolidated Rock Products decision as necessitating formalistic dollar valuations, stating that "we are satisfied that different facts and a different law, under which the reorganization of railroads is authorized, distinguish this case from the Consolidated Rock Products case." *In re Chicago and North Western Railway Co.*, 126 F. (2d) 351, 368 (C.C.A. 7th, 1942)

The same general principles and procedure followed by the Commission in the present case as to the manner in which its findings and conclusions should be stated and as to the extent and nature of the determinations of value required have been followed by the Commission in numerous other railroad reorganizations now pending before the Courts or the Commission, as well as in other reorganizations which have already been consummated.* Included among the cases in which plans of reorganization approved by the Commission in reports and orders substantially similar to those in the present case have been approved by the District Courts to which they were certified and in most cases actually consummated are *In re Chicago Great Western Railroad Company*, 29 F. Supp. 149 (D.C. N.D. Ill. E. D., 1939); *In re Erie Railroad Company*, 37 F. Supp. 237 (D.C. N.D. Ohio E. D., 1940); *In re Missouri Pacific Railroad Company*, 39 F. Supp. 436 (D.C. D. Mo. E. D., 1941); *In re Louisiana and North West Railroad Company*, 36 F. Supp. 636; ibid., 639 (D.C.

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* The aggregate principal amount of the outstanding loans from Reconstruction Finance Corporation to railroads or trustees of railroads now in reorganization under Section 77 whose plans of reorganization may be affected by the decision of the Circuit Court of Appeals for the 7th Circuit in the present case, exceeds $125,000,000. If the procedural requirements as to valuation set out in the decision of the Circuit Court of Appeals were to be adopted, it would probably be necessary for substantially all of the pending reorganization proceedings to be referred back to or reopened by the Commission, and would upset much of the work which has been done and the plans thus far approved and result in very substantial delay in the consummation of all railroad reorganizations under Section 77.

S.D. N.Y., 1938, 1939); *In re Copper Range Railroad Company,* unreported opinion (D.C. W.D. Mich. N. D., October 13, 1936); *In re Chicago, South Shore and South Bend Railroad Company,* unreported opinion (D.C. N.D. Ind. South Bend D., December 8, 1936); *In re Reader Railroad,* unreported opinion (D.C. D. Ark. El Dorado D., April 24, 1937); *In re Savannah and Atlanta Railway Co.,* unreported opinion (D.C. S.D. Ga. Savannah D., February 5, 1938); *In re Kansas City, Kaw Valley & Western Railroad Company,* unreported orders (DC.D. Kans. First D., January 23, 1939, September 25, 1940 and January 4, 1941); *In re Chicago and Eastern Illinois Railroad Company,* unreported opinion (D.C. N.D. Ill. E.D., June 16, 1939); *In re Oregon, Pacific and Eastern Railway Company,* unreported opinion (D.C. D. Oregon, September 9, 1939); *In re Spokane International Railway Company,* unreported order (D.C. E.D. Wash. N.D., March 2, 1940); *In re Yosemite Valley Ry Co.,* unreported opinion (D.C. S.D. Cal. N.D. October 28, 1941).[10]

In addition to the present case plans of railroad reorganization approved and certified by the Commission under Section 77 and subsequently approved by

[10] While plans approved by the Commission have been in a few cases rejected by the District Court to which they were certified, in no instance has there been any suggestion of disagreement by a District Court with the form of the Commission's reports or, with one exception, *In the Matter of New York, New Haven & Hartford Railroad Company,* not yet reported (D. Conn., December 8, 1941), the extent of its findings as to valuation.

the District Court have come before the Circuit Courts of Appeals in three instances. *In re Western Pacific Railroad Company*, 124 F. (2d) 136 (C.C.A. 9th, 1941); *In re Chicago and North Western Railway Company*, 126 F. (2d) 351 (C.C.A. 7th, 1942); *Akron, Canton & Youngstown Railway Company* v. *Hagenbuch*, 128 F. (2d) 932 (C.C.A. 6th, 1942). The Western Pacific decision, in which the Circuit Court of Appeals for the Ninth Circuit imposed even more excessively formalistic requirements as to findings of valuation than the Court below, is now pending in this Court on writ of certiorari as a companion case to the present proceeding. In both the Chicago and North Western and the Akron, Canton & Youngstown cases, which are now pending on applications for writs of certiorari, the Circuit Courts of Appeal upheld the Commission's plan. The decision of the Circuit Court of Appeals for the Seventh Circuit in the Chicago and North Western case has been discussed above (pp. 25-27). In the Akron, Canton & Youngstown case the Circuit Court of Appeals for the Sixth Circuit upheld the confirmation by the District Court of the Commission's plan of reorganization for that road, saying in part:

> "Appellants urge that the Commission failed to observe two procedural requirements under the Bankruptcy Act: (1) That it made no findings of fact; (2) That its ultimate conclusion as to the value of the assets is without substantial supporting evidence.
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> * * * *
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> "It is the duty of the Commission to certify

the plan to the court, together with a transcript of the proceedings before it and a copy of the report and order approving the plan. Section 77, sub. d, 11 U.S.C.A. § 205, sub. d.

"Such report should contain the Commission's findings of fact as to the plan and its recommendation thereon. The report should not be made up of mere conclusions, but should show the issues between the parties to the reorganization and the facts the Commission finds with reference to them. The Commission should also make appropriate references to the evidence, but the report need not specify the weight given to any particular part thereof or disclose the mental operations by which the decision is reached. The report must be considered in its entirety and not any isolated statements therein. Baltimore & O. Railroad Company v. United States, 298 U.S. 349, 359, 56 S. Ct. 797, 80 L. Ed. 1209. The Commission's report should contain its findings of fact and such findings must be consistent with the evidence. The findings of fact may be informal and need go no further than the ultimate facts. *United States* v. *State of Louisiana*, 290 U.S. 70, 80, 54 S. Ct. 28, 78 L. Ed. 181; *Mills* v. *Lehigh Valley Railroad Company*, 238 U.S. 473, 480, 35 S. Ct. 888, 59 L. Ed. 1414."

II

THE FINDINGS AND CONCLUSIONS OF THE COMMISSION WITH RESPECT TO THE ADDITIONS AND BETTERMENTS FUND ARE ADEQUATE

Under the plan of reorganization approved by the Commission and the District Court provision is made

for an additions and betterments fund, into which annual payments of $2,500,000 are to be made. These payments are mandatory, but only if and to the extent earned (cumulative for one year), and are to be a charge against income immediately following the payment of fixed charges (R. 1333).[11] In other words, the Commission, as the administrative body experienced in railroad finances, has found in effect, and the District Court has approved the conclusion, that in order to insure the proper operation of the Debtor's properties such an amount, to be paid into what is technically described as an additions and betterments fund, must be made available from earnings, and accordingly cannot properly be regarded as distributable as interest or dividends to security holders of the reorganized company or included in the capitalization into new securities of the actually distributable earnings. In this connection it should be borne in mind that railroad companies have not heretofore customarily accrued depreciation upon assets other than equipment, and the plan provides (R. 1333-1334) that if the new company (as the Commission has required by recent order shall be done by railroad companies generally[12]), establishes

[11] Under the Commission's plan discretionary additions to the fund, not exceeding a further $2,500,000 per year, are also authorized out of available net income after payment of the interest upon the Series A General Mortgage Income Bonds to be issued in the reorganization (R. 1335).

[12] Order of June 8, 1942, effective January 1, 1943 and applicable to road property accounts other than track accounts. For previous discussions by the Commission of the problem

a depreciation reserve with respect to its roadway and structures, the additions and betterments fund shall be paid from the amount credited to such reserve for the applicable income period to the extent that such amount is adequate therefor.

After having described the provision of the plan for the additions and betterments fund and the objections made thereto (R. 2306-2307), the Circuit Court of Appeals stated:

> "The serious attack made on that portion of the plan which calls for the mandatory payment of $2,500,000 into the Additions and Betterments Fund, calls for no extended discussion. Counsel contend that the sum is excessive and unfair and does not affect all security holders equally. We think otherwise.
>
> "While there must be more fact findings upon which to reach a final conclusion on this, as well as the other phases of the plan, we believe the Commission is entirely sound in its position that a fund for Additions and Betterments should be created. In fact we find few things in the plan which appeal stronger than this provision.
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> "Failure to provide against financial and commercial storms and other adversities which affect railroads, like other industries, accounts for much of the condition of the railroads today. The possible avoidance of such recurrence will

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of depreciation of fixed assets see *Telephone and Railroad Depreciation Charges*, 118 I.C.C. 295 (1926); *Telephone and Railroad Depreciation Charges*, 177 I.C.C. 351 (1931). See also Interstate Commerce Act, Section 20(4), 49 U.S.C. §20(4).

> be aided by this or a similar provision. It would be improper to pass directly upon the reasonableness of the amount, however, until the findings which must be made are before us. However, we may say that there is evidence that would amply warrant an allowance for such an item, and also the amount adopted by the Commission. But findings there must be, based on the evidence, which support both the allowance and the amount of the allowance." (R. 2313; 124 F. (2d) at 765)

The detailed findings and conclusions of the Commission with respect to the additions and betterments fund appear in its report[13] and supplemental report,[14] and the provisions for the fund are specifically stated in the plan approved by the Commission (R. 1332-1334). The Commission first summarized the terms proposed for such a fund by various parties to the proceedings, and the annual charges of the Debtor or its trustees for additions and betterments during each year from 1928 to 1937, together with a statement of the cash obtained each year from equipment depreciation charges, road retirements and salvage and the testimony of various witnesses as to the future needs of the property (R. 2192, 2203). After referring to the contention of the Debtor that $5,000,000 per year was required for the additions and betterments fund as compared to $2,500,000 recommended by the Institutional

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[13] R. 2192-2193, 2203-2204, 2219, 2223-2244, 2238-2239, 2266.

[14] R. 1287-1292, 1293-1294.

Investors Committee, the Commission stated that this difference of view

> "involves not only the method of treating retirements, salvage, and depreciation but also the question of judgment as to the future necessities of the system. It appears that the committee considers that approximately $10,700,000 of cash will be available annually for the additions and betterments fund and the reserve and retirement fund, such amount including retirements, salvage, and depreciation on equipment, while the debtor estimates its average capital requirements for the next five years at about $12,900,000 a year, leaving $2,200,000 or more, which, if the expenditures were not curtailed, would have to be financed by the issue and sale of new securities. Testimony for the debtor tends to support the foregoing estimate of future requirements but in such a matter exactness cannot be expected. We think that the situation will be met by the provisions for the additions and betterments fund hereinafter made, by which the contributions to the fund in respect of any income period will be part mandatory and part in the discretion of the management." (R. 2223)

The Commission thereafter stated in detail the terms of the additions and betterments fund which it approved (R. 2238-2239). In its supplemental report of June 4, 1940, dealing with petitions for modification of the provisions with respect to the additions and betterments fund approved in its original order, the

Commission again considered in detail the evidence of the needs of the property and the provisions for the additions and betterments fund (R. 1287-1292, 1293-1294). With certain slight modifications with respect to the making of payments into the fund, the conclusions of the Commission with respect to the necessity for and the proper amount of the additions and betterments fund were reaffirmed, and such provisions accordingly incorporated (R. 1332-1335) in the plan approved and certified to the District Court.

"There is evidence," said the Circuit Court of Appeals "that would amply warrant an allowance for such an item, and also the amount adopted by the Commission"; and "we find few things in the plan which appeal stronger than this provision." The findings and conclusions of the Commission, it is submitted, are more than adequate to support both the provision of the plan for an additions and betterments fund, and the amount of the fund provided for.

III

THE FINDINGS AND CONCLUSIONS OF THE COMMISSION WITH RESPECT TO THE ALLOCATION OF THE SECURITIES OF THE REORGANIZED COMPANY AMONG THOSE FOUND ENTITLED TO SHARE THEREIN ARE ADEQUATE

THE NEW SECURITIES AVAILABLE FOR ALLOCATION

In considering the findings and conclusions of the Commission with respect to the allocation of the securities of the reorganized company among the creditor

interests found entitled to share therein, it is important to bear in mind the extent of the maximum new capitalization approved under the plan and the amounts of the new securities available for such allocation. With a full statement of its conclusions and the reasons therefor, which demonstrates that the Commission gave fundamental importance to the earning capacity of the Debtor's properties but considered also all other possible elements of value, the Commission under the approved plan has fixed a maximum permissible capitalization of $548,533,321 for the reorganized company (R. 2218-2221, 1307, 1312). This determination has been specifically approved both by the District Court (R. 1872-1875; 36 F. Supp. at 205) and by the Circuit Court of Appeals, which, except for the question of the additions and betterments fund above discussed, confined its request for additional findings entirely to matters relating to the allocation of new securities among existing bondholders and creditors (R. 2334). In its opinion the Circuit Court of Appeals stated:

> "Our present conclusion is that the record supports the new plan as far as the amount of indebtedness which this railroad will bear is concerned. We think the reorganization plan which simplifies the financial structure is also to be approved and commended." (R. 2313; 124 F. (2d) at 765)

Furthermore, much as some of the parties might so desire, the capitalization of the reorganized company

cannot be entirely represented by first mortgage bonds. Obviously, the earnings of anticipated prosperous years, reflected in the capitalization and which the company will have available for the payment of preferred and common stock dividends in those years, will not be available in other years and could not be justifiably made the basis of fixed interest obligations. Earnings which the company may reasonably be expected to have in normal as distinguished from peak years may reasonably be made the basis of contingent interest charges, while fixed charges themselves, in order to be certainly payable and to avoid return of the Debtor's properties to the bankruptcy court, must be fixed at an amount which can be met by the earnings which will be actually distributable even during a period of depression. As summarized by the District Court, "Contrary to the contention of the Debtor, the Commission was charged with the duty, not only of determining the amount of fixed interest debt of the new Company, but also the contingent interest debt and it was in the public interest that the contingent interest debt be such that, as stated by the Commission, the total debt should bear a proper relation to the total capitalization and such as to make the payment of contingent interest a probability and of dividends a reasonable prospect, at least on the preferred stock." (R. 1873; 36 F. Supp. at 204)

In accordance with these principles and with the findings and conclusions above discussed as to the

necessity for the provision of an additions and betterments fund, the Commission determined (R. 1899) that the total capitalization should be divided into $108,780,470 of fixed interest debt (including $34,506,999 of undisturbed obligations, $15,350,300 of Terre Haute bonds to be assumed on conditions hereinafter discussed [15] and $58,923,171 of first mortgage bonds), $115,257,480 of general mortgage income bonds, $6,578,700 contingent interest Terre Haute bonds [15] $111,347,846 par value of preferred stock and 2,131,475¼ shares of common stock having no par value. These, accordingly, were the securities available under the approved plan for distribution to the interested parties.

THE COMMISSION'S ALLOCATION

In considering the allocation of these securities the Commission first ascertained and found the claims against the Debtor of the various creditor interests. These included, as of the effective date of the plan, equipment trust obligations in the amount of $33,322,999, a bank loan of the trustees in the amount of $1,184,000, and the claim of Reconstruction Finance Corporation in the principal amount, as of the effective

[15] See *infra*, Point IV, pp. 83-104. The total of $21,929,000 of Terre Haute bonds, if assumed, would bear fixed interest of 2.75% and contingent interest of 1.50% but are classified by the Commission in the manner shown in the text for convenience in distinguishing fixed interest and contingent interest debt. See R. 1317, 2216.

date of the plan, of $11,947,164.[16] In addition, the Commission found the Debtor's mortgage indebtedness as of the effective date of the plan to be briefly as follows:

> (1) $150,000,000 principal amount of General Mortgage Bonds originally issued by The Chicago, Milwaukee & St. Paul Railway Company, the Debtor's predecessor, but assumed by the Debtor, of which $138,788,000 were found to be in the hands of the public and $11,212,000 pledged with Reconstruction Finance Corporation. As of December 31, 1938 the accrued and unpaid interest on the publicly held General Mortgage Bonds was $17,580,193.
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> (2) $9,866,000 principal amount of the Debtor's First and Refunding Bonds, of which $8,665,000 principal amount were found to be pledged with Reconstruction Finance Corporation, $258,000 (subsequently cancelled) with the trustee under the Debtor's equipment

[16] After deducting a payment of $290,000 made shortly after the effective date of the plan, and $973,299 cash in the hands of the First and Refunding Mortgage Trustee on the effective date but allocated to Reconstruction Finance Corporation under the plan. Through the application of proceeds of its collateral, Reconstruction's claim has been since further reduced. See *infra*, p. 51, note 17.

Various items of indebtedness existing at the time of the filing of the Debtor's petition, including certain equipment trust obligations, a loan from The Railroad Credit Corporation and a loan originally made by the Public Works Administration but subsequently acquired by Reconstruction Finance Corporation, have been liquidated during the proceedings, the last two items largely through the proceeds of the collateral held therefor. (R. 1317)

trust, Series M, and $943,000 held in the treasury of the trust estate.

(3) $106,395,096 principal amount of the Debtor's 50-Year Mortgage Bonds, all outstanding in the hands of the public except for $426,317 principal amount which, as of June 30, 1935, was held for exchange for securities not presented for this purpose under the previous reorganization. The accrued and unpaid interest on these bonds as of December 31, 1938 amounted to $20,835,706.

(4) $182,873,693 principal amount of the Debtor's Convertible Adjustment Mortgage Bonds, all outstanding in the hands of the public except $152,487 principal amount which, as of June 30, 1935, was held for exchange for securities not presented for this purpose under the previous reorganization. As of December 31, 1938 the interest accrued and unpaid on the Convertible Adjustment Bonds amounted to $79,550,055.

(5) $2,155,000 principal amount of Milwaukee and Northern Railroad Company First Mortgage Bonds, of which $2,117,000 were in the hands of the public and $38,000 pledged under the Debtor's First and Refunding Mortgage. In addition $103,204 of unpaid interest had accrued on these bonds as of December 31, 1938.

(6) $5,092,000 principal amount of Milwaukee and Northern Railroad Consolidated Mortgage Bonds, of which $5,072,000 were in the hands of the public and $20,000 pledged under the Debtor's First and Refunding Mort-

gage. The accrued and unpaid interest on these bonds as of December 31, 1938 was $247,260.

(7) $5,700,000 principal amount of Chicago, Milwaukee and Gary Railway Company First Mortgage Bonds, of which $3,000,000 were in the hands of the public and $2,700,000 pledged under the Debtor's First and Refunding Mortgage. As of December 31, 1938, the accrued and unpaid interest on the Gary bonds totaled $562,500.

(8) $301,000 principal amount of Bellingham Bay and British Columbia Railroad Company First Mortgage Bonds, all pledged with Reconstruction Finance Corporation as security for its loans to the Debtor.

(9) The four bond issues affecting all or a part of the properties leased from the Terre Haute, which will be discussed separately in Point IV below.

The complicated mortgage liens of these various issues are discussed below in connection with the findings of the Commission as to the pertinent issues (pp. 54-81). In general, however, it may be stated that the General Mortgage is a lien upon the Debtor's lines east of the Missouri River. The First and Refunding Mortgage, the 50-year Mortgage and the Convertible Adjustment Mortgage constitute liens, in the order stated, upon the Debtor's western lines, and upon stocks and bonds of substantial value. The two Milwaukee and Northern Mortgages, the Gary Mortgage and the Bellingham Bay and British Columbia Mortgage are

divisional issues constituting liens upon particular portions of the Debtor's properties.

In addition, the unsecured claims against the Debtor amounted according to the record, as of September 30, 1937, to $445,162, exclusive of potential claims arising in connection with the Terre Haute bonds and lease and possible deficiency claims of the Debtor's bondholders (R. 2165-2175).

Under the plan approved by the Commission, the equipment trust obligations in the amount of $33,322,999 and the trustees' bank loan in the amount of $1,184,000 (subsequently paid off, appropriate adjustment being provided for in the plan) are left undisturbed. Reconstruction Finance Corporation is allotted in respect of its loans to the Debtor all cash held by the First and Refunding Mortgage Trustee at the time of the consummation of the plan, and for the remainder of its total claim 100 per cent in new first mortgage bonds.[17] Of the bond issues referred to (a) the Milwaukee and Northern First Mortgage Bonds receive 70 per cent in first mortgage bonds and 30 per cent in general mortgage income bonds; (b) the General Mortgage Bonds and the Milwaukee and Northern

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[17] As the result of further reduction in the claim of Reconstruction Finance Corporation through application of the proceeds of the collateral held by it, the principal amount of Reconstruction's claim is now $10,780,762.50. Appropriate provision for a corresponding reduction in the amount of new first mortgage bonds to be received by Reconstruction Finance Corporation is made in the plan. (R. 1339, 1342)

Consolidated Mortgage Bonds are each allotted 25 per cent in first mortgage bonds, 35 per cent in Series A and 20 per cent in Series B general mortgage income bonds, and 20 per cent in preferred stock; (c) the 50-Year Mortgage Bonds receive 15 per cent in Series B general mortgage income bonds, 60 per cent in preferred stock and 25 per cent in common stock; (d) the Convertible Adjustment Mortgage Bonds receive 1,749,492 shares of common stock in respect of their mortgage security and 39,163 shares in respect of their deficiency claim, with provision for possible upward adjustment of the latter amount dependent upon the extent of the unsecured claims; and (e) the Gary First Mortgage Bonds receive 75 per cent in preferred stock and 25 per cent in common stock. The unsecured claims against the Debtor are allotted 55,000 shares of common stock, of which 39,163 shares are allocated to the Adjustment Mortgage bondholders in respect of their deficiency claim as above stated.

The Circuit Court of Appeals, as we have pointed out, was satisfied that "The plan as such, ignoring the absence of findings, has support in the evidence. It violates no requirements (save findings) announced in the Consolidated Rock Products case" (R. 2312; 124 F.(2d) 754 at 764), and specifically voiced its approval of the provisions of the plan with respect to several particular security issues. The court felt, however, that the Commission should have made some other or additional findings to support its allocation. We turn therefore to the actual findings of the Commission.

THE COMMISSION'S FINDINGS

In addition to its specific findings and conclusions with respect to each particular issue discussed below the Commission in its original report of February 12, 1940 made the over-all finding that "the plan of reorganization herein described, which differs from any of the plans presented, will meet with the requirements of subsections (b) and (e) of Section 77 of the Bankruptcy Act, as amended, and will be compatible with the public interest." (R. 2265) In its supplemental report of June 4, 1940, after careful consideration of the petitions of various parties requesting modifications of the distribution of new securities initially approved, the Commission stated:

> "* * * The capital structure and allocation of securities shown in the approved plan were determined from a careful consideration of the evidence, and we find nothing in the petitions now before us to justify the numerous modifications requested. We are convinced that, within the limits of total capitalization and total fixed charges approved, any material changes in the distribution of the new securities would render the distribution less equitable from the standpoint of relative rights." (R. 1307)[18]

[18] And the District Court, after carefully considering the objections made to the plan, concluded:

> "The court is of the opinion that the plan of reorganization certified by the Commission observes the rules of law concerning the priority rights of the various claimants in all respects. The court approves the finding of the Commission 'that, within the limits of total capitalization and total fixed charges approved, any material changes in the

In addition to these over-all findings, the Commission set out in detail its findings and conclusions with regard to the particular bond issues above referred to. These may be summarized as follows:

(A) *General Mortgage Bonds.* The Commission (R. 2165-2167) set out the various series of General Mortgage Bonds comprising the total of $150,000,000 principal amount outstanding, including the amounts, interest rate and maturity dates of the respective series and the pledge of the $11,212,000 of series G Bonds with Reconstruction Finance Corporation. It found the General Mortgage to be a first lien upon the Debtor's eastern lines (those east of Mobridge, South Dakota) with the exception of the properties subject to

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distribution of the new securities would render the distribution less equitable from the standpoint of relative rights.' The plan of distribution followed by the Commission would seem to be in accord with sound principle and should have judicial approval.

* * * *

"In this connection, it should be noted that the institutional investors group owns over 32 per cent of these general mortgage bonds, and this group, which likewise owns a substantial amount of all of the issues involved, feels that the entire allocation of the securities of the new company under the plan is fair and equitable. The basis of distribution is, of course, not capable of exact mathematical computation. The Commission and the court are required to make and approve a fair and equitable distribution of the securities available and the court believes that this has been done in this instance." (R. 1887-1889; 36 F. Supp. at 211, 212).

the Milwaukee and Northern, Gary and Terre Haute Mortgages referred to below.[19] The Commission also found the General Mortgage to be a lien upon substantial amounts of equipment and certain other property and that there were no deficiencies in compliance with the equipment replacement clause under this Mortgage (R. 2167).

With respect to elements of physical value, the report of the Commission's Bureau of Valuation, as pointed out by the Commission in its report of February 12, 1940, stated that as of December 31, 1935 the cost of reproduction of the General Mortgage lines less depreciation, plus the value of lands and rights, was $359,115,599.[20] (R. 2250; I. C. C. Bureau of Valuation Report, Sheet 4, included in unprinted record)

In its report the Commission fully discussed the past and prospective earnings of the Debtor's properties, their traffic sources and prospects, including the General Mortgage lines, to which it referred as "the heart of the system" (R. 2215) and "those upon which

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[19] Some contention was raised, late in the hearings before the Commission, as to whether the General Mortgage or the First and Refunding Mortgage was prior in lien on seventeen minor items known as the "pieces of lines east" (R. 1129-1151, 2171, 2199-2200, 2252-2254). The lien upon these inconsequential pieces of line and the consequent allocation of their small earnings, however, would not affect substantially the allocation of new securities to the two mortgages involved.

[20] This figure is composed of $290,636,520 cost of reproduction less depreciation and $68,479,079 value of lands and rights.

the other divisions are largely dependent for revenue." (R. 2250) In addition a segregated earnings study was made for the year 1936, in which earnings were the best since 1930 and which was the latest year for which information was then available (R. 2180). For this period the study showed the income of the General Mortgage lines available for interest to be $8,716,847, or $7,561,688 after deducting interest charges on prior equipment obligations. "The latter sum is 1.16 times interest charges on the general mortgage bonds, including the series G bonds pledged with the Finance Corporation." (R. 2250) After consideration of the earnings figures, the Commission stated that "on the basis of income available in 1936 for payment of interest" the General Mortgage Bonds and the Milwaukee and Northern Consolidated Mortgage Bonds,[21] were substantially on a parity, and concluded that the bondholders of both these issues should receive under the plan the treatment stated below.

The Commission also carefully considered, particularly in relation to the treatment accorded the 50-year Mortgage Bonds, the holders of which were the chief objectors to the treatment provided for the General Mortgage Bonds, the extent to which the provision made for the General Mortgage Bonds could be represented by new first mortgage bonds and the extent to which it must necessarily be represented by other types of new securities (R. 2225, 1307-1308). As the result of that consideration it allocated to the Gen-

[21] Discussed below, pp. 74-76.

eral Mortgage Bonds all of the new first mortgage bonds provided for in the total capitalization remaining after provision had been made for certain admittedly prior claims and with respect to the Milwaukee and Northern issues as discussed below. The General Mortgage Bonds were thus allocated 25% in first mortgage bonds, general mortgage income bonds for 55% of their claim and preferred stock for the remaining 20%. This provision was specifically approved by the District Court (R. 1887-1889) and indeed apparently also by the Circuit Court of Appeals, which stated:

> "In view of the reversal and remanding of this case for the making of findings, which we find it is necessary to order, we will not discuss at great length, or in great detail, the fairness of the plan with respect to these two mortgages. [the General Mortgage and the 50-year Mortgage Bonds] It is sufficient to observe that the fact situation permits of a plan such as the Commission formulated and approved. The plan as such, ignoring the absence of findings, has support in the evidence. It violates no requirements (save findings) announced in the Consolidated Rock Products case.
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> "The General Mortgage bondholders, apparently, underestimate the value of the new stock and the Series A and B bonds in the new organization. Moreover, it must be kept in mind that these General Mortgage bondholders, at present, have holdings that are far from Class A securities. They are bonds on which

interest is in default in large sums and has been for a substantial period. The properties upon which this mortgage is a first lien can hardly stand alone. It is dependent in part for its showing upon other sections of the road. Its condition has not been improving. Its maintenance charges, especially in the winter time, are large. Unusually fine paved highways along its side give promise of continued competition from trucks and busses, which is far from reassuring.

"Accepting, as we do, the necessity for a drastic reduction in indebtedness and interest requirements and realizing that each of these divisions, to a certain extent, depends upon the existence and business of other branches of the system, we are unable to say the evidence fails to establish the fairness of the plan so far as these bonds are concerned.

"If the proposition were an original one, it it true, we can readily see how a larger percentage of the new plan first mortgage bonds might have been given to holders of the General Mortgage bonds. On the other hand, while there is a difference in the priorities of the first mortgage bonds and the Series A bonds of the new issue, this may be made up in increased interest rates of the new bonds, especially if the increased revenues of the company, as disclosed during the year 1941, are maintained even in part. There is, however, in our opinion, a serious question presented due to the small percentage (25%) of the First Mortgage bonds given to the holders of old

> General Mortgage bonds. Our suggestion is that if any revision should be made, this percentage might be increased and the percentage of Series B and preferred and common stock, reduced." [22] (R. 2311-2313; 124 F. (2d) at 764-765)

The provisions of the approved plan with regard to the General Mortgage Bonds were thus the result of full consideration by the Commission of the facts with respect to these bonds, and were fundamentally based upon the criterion of earning capacity. The findings and conclusions of the Commission, set out in detail in its reports are, it is submitted, entirely adequate to support such allocation. After considering the petitions of various parties for modification of this allocation, the Commission in its supplemental report of June 4, 1940 specifically found that it was "convinced that, within the limits of total capitalization and total fixed charges approved, any material changes in the distribution of the new securities would render the distribution less equitable from the standpoint of relative rights." (R. 1307)

(B) *First and Refunding Mortgage Bonds.* The

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[22] In making this suggestion, however, the Circuit Court of Appeals does not suggest any increase in the total amount of new first mortgage bonds provided for under the plan, nor suggest from which of the parties first mortgage bonds might be taken away for the benefit of the General Mortgage bondholders if the total amount is not increased. The careful consideration of these problems by the Commission is discussed in the text. See R. 2225, 1307-1308.

Commission also found in some detail the facts with regard to the First and Refunding Bonds outstanding and with regard to the lien securing them. The First and Refunding Mortgage is a first lien upon the "lines west" (those west of Mobridge, South Dakota), with the exception of the property subject to the Bellingham Bay and British Columbia Mortgage referred to below, and a lien upon the eastern lines subject to the General Mortgage and liens prior thereto. It is also a lien upon the stock of the Indiana Harbor Belt Railway owned by the Debtor, the Terre Haute lease and stock, the stock of the Chicago, Milwaukee and Gary Railway Company and the stocks and bonds of other railroad and terminal companies, and certain equipment. The Commission referred in particular to the testimony of record as to the high value of the Indiana Harbor Belt stock. (R. 2170-2173) The earnings and other elements of value of the "lines west", and the findings and conclusions of the Commission with respect thereto, appear in great detail in the Commission's discussion of the 50-year Mortgage Bonds, which have a second lien thereon subordinate to the First and Refunding Mortgage.

As the Circuit Court of Appeals stated, "No challenge of the plan is made so far as it affects this mortgage." (R. 1304; 124 F. (2d) at 760) Since the entire amount of First and Refunding Mortgage Bonds actually outstanding is pledged as part of the collateral held by Reconstruction Finance Corporation, no direct allocation of new securities to the First and Refunding Bonds was made by the Commission, al-

though Reconstruction Finance Corporation was allocated all of the cash held by the mortgage trustee on the consummation of the plan, and in view of its entire collateral 100% of its remaining claim in new first mortgage bonds. As the Commission found, "the margin of security for these loans is unusually large" (R. 2217), and the right of Reconstruction Finance Corporation to such treatment is clear upon the record and unchallenged, so far as we are aware, by any party to the proceeding. It seems clear that so far as the First and Refunding Bonds are concerned no additional findings by the Commission were or could properly be required.

(C) *50-Year Mortgage Bonds.* In its original report of February 12, 1940 the Commission found the outstanding principal amount of the Debtor's 50-year Mortgage Bonds to be $106,395,096, plus accrued interest as of December 31, 1938 amounting to $20,835,706, and that the mortgage securing these bonds constituted a lien, subject to the First and Refunding Mortgage and all liens prior thereto, upon the property subject to that mortgage (R. 2172).

The Commission considered in some detail (R. 2251-2255) the earnings analyses which had been made with respect to this mortgage, and the modifications and adjustments which it had been contended should be made therein. In so doing the Commission discussed, among other things, the relationship between the properties subject to the General Mortgage and the 50-year Mortgage, and of the earnings from the

respective properties. Thereafter the Commission concluded:

> "If the holders of the 50-year bonds are assigned a part of the new series B income bonds only, as herein provided, they will begin to share earnings with the general mortgage bonds and Northern consolidated bonds after $9,675,000 of prior charges, including a payment of $2,500,000 to the additions and betterments fund, such charges reflecting the respective amounts of equipment obligations, etc., upon which this approved plan is based. We think that this treatment goes far toward resolving the doubts as to the accuracy or fairness of the allocation of earnings in favor of the 50-year bonds, without injustice to the general mortgage bonds. In any event, under the new capital structure which we contemplate, it would be impracticable to assign to these claims new securities wholly junior to those assigned to the holders of the general mortgage bonds. Also, it is impracticable to avoid the assignment of preferred stock to part of the claims of both the 50-year bonds and the general mortgage bonds, resulting in a parity of treatment to the extent of 20 percent of each claim. (See appendix.) However, the 50-year bonds will rank wholly junior in status to the claims of the Finance Corporation and the Northern first mortgage bonds. We see no means by which the exact present lien position of the general mortgage bonds or the 50-year bonds can be

preserved except under a prohibitive mortgage structure.

"We conclude that the holders of the 50-year bonds should be entitled to receive the securities of the new company as provided herein, viz., on the basis of new general mortgage income series B bonds, equal to 15 percent of the total claim for principal and interest, new 5 percent preferred stock equal in par value to 60 percent, and new common stock equal, at the rate of $100 a share, to 25 percent." (R. 2254-2255)

In its supplemental report of June 4, 1940 the Commission, in dealing with objections of representatives of the 50-year Mortgage Bonds to the earnings segregation figures referred to in its previous report, and to the alleged failure of the Commission to consider the elements of physical value of property subject to the 50-year Mortgage,[23] specifically restated its findings and conclusions with regard to these matters:

"The objections of the holders of the 50-year mortgage bonds to the earnings study as a basis for the allocations of new securities were stated and discussed in our prior report. The bondholders' witness analyzed the debtor's compu-

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[23] The report of the Commission's Bureau of Valuation, filed in the proceeding on the order of the Commission pursuant to Section 77(c)(11), showed the original cost of the railroad property subject to the first lien of the First and Refunding Mortgage and the second lien of the 50-year Mortgage to be $217,052,949, the cost of reproduction less depreciation $190,054,042, and the value of lands and rights not included in the latter figure $7,929,980 (R. 2247; I. C. C. Bureau of Valuation Report, Sheet 3, included in the unprinted record).

tations which showed a loss of approximately $1,000,000 in 1930 on the western lines, and concluded that on the basis of system earnings of about $12,300,000 a year approximately $2,000,000 was earned in that year for the 50-year mortgage bonds, or 38 percent of their interest requirements. On the same basis the interest requirements on the general mortgage bonds were found to be fully earned.

"In addition to these estimates, the record contains studies, referred to in our previous report, showing losses by the western lines of $142,591 in 1930 and $1,540,808 in 1931, before payment of interest. We are satisfied that on any reasonable basis of allocation between the lines west and the other parts of the system, the lines west cannot be expected to earn any sum for the payment of interest. In years when the system earnings approach $10,000,000, some interest is apparently earned for the 50-year mortgage bonds under the present capital structure, but this reflects system operation and does not demonstrate any earning power for the western lines.

"The 50-year mortgage bondholders criticize our previous conclusions as to the value of their interest in the property of the debtor on the ground that we have not considered the physical value of the property subject to their mortgage. The elements of physical value referred to were before us, and were considered by us. It is important that the lien of these bondholders upon the western lines and upon the securities indirectly pledged under the mort-

gage is subject to claims of approximately $13,000,000 secured by the prior lien of the first and refunding mortgage. It is clear that in the light of the above-described evidence as to earning power of the western lines, the same weight cannot be accorded the physical value of the properties as might be under conditions of higher earning power.

"It will be observed that the new capitalization which we have approved permits only 25 percent of the general mortgage claim to be translated into new first mortgage bonds and only 35 percent into income bonds. With relation to this treatment, we are satisfied that the treatment of the 50-year mortgage bonds must be regarded as fair." (R. 1307-1308)

Objection was made by certain of the parties to the simplification of the capital structure of the reorganized company under which system mortgages were created and the General Mortgage and 50-year Mortgage bondholders given their fair and equitable share, as found by the Commission, of the new system securities. In this connection the Commission, as noted above, stated in its original report that "we see no means by which the exact present lien position of the general mortgage bonds or the 50-year bonds can be preserved except under a prohibitive mortgage structure." (R. 2255) In the Commission's supplemental report of June 4, 1940 the importance of this simplification of the corporate structure was again emphasized by the Commission:

> "The question of the formation of a separate corporation for the Milwaukee's western lines or of the separation of the western lines from the rest of the system by a separate mortgage has been considered by us heretofore in connection with the plan and we are of the opinion that there would result no advantage therefrom to the present holders of the 50-year mortgage bonds and the general mortgage bonds, respectively. It seems to us of great importance that a completely unified system be created through the reorganization and that the capital structure be not complicated by numerous mortgages. Thus, the plan eliminates the Milwaukee & Northern mortgages and the Gary mortgage. Properly, it should eliminate the Terre Haute mortgages also." (R. 1307)

In this procedure, based upon the full and complete findings above outlined and approved both by the District Court (R. 1888) and the Circuit Court of Appeals (R. 2313), the Commission anticipated the express holding of this Court in *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510 (1941), that simplification of the debtor's capital structure, and the elimination of a complicated mortgage set-up, not only properly may but in many cases must be a primary objective of a plan of reorganization. In the Consolidated Rock Products case this Court stated:

> "The Circuit Court of Appeals, however, made certain statements which if taken literally do not comport with the requirements of

the absolute priority rule. It apparently ruled that a class of claimants with a lien on specific properties must receive full compensation out of those properties, and that a plan of reorganization is *per se* unfair and inequitable if it substitutes for several old bond issues, separately secured, new securities constituting an interest in all of the properties. That does not follow from *Case* v. *Los Angeles Lumber Products Co., supra.* If the creditors are adequately compensated for the loss of their prior claims it is not material out of what assets they are paid. So long as they receive full compensatory treatment and so long as each group shares in the securities of the whole enterprise on an equitable basis, the requirements of 'fair and equitable' are satisfied.

"Any other standard might well place insuperable obstacles in the way of feasible plans of reorganization. Certainly where unified operations of separate properties are deemed advisable and essential, as they were in this case, the elimination of divisional mortgages may be necessary as well as wise. Moreover, the substitution of a simple, conservative capital structure for a highly complicated one may be a primary requirement of any reorganization plan. There is no necessity to construct the new capital structure on the framework of the old." (312 U.S. at 530-531)

The allocation of new securities to the 50-year Mortgage Bonds provided in the Commission's plan

was specifically approved as fair and equitable by the District Court (R. 1889-1890). And the Circuit Court of Appeals, after referring to the requirements of the Consolidated Rock Products case, stated with reference to this issue:

> "Accepting the rule there announced for determination of value (to-wit, earning power) the 5's of '75 have, we think, no legitimate complaint. Sec. 77, sub. e does not change our conclusion." (R. 2312; 124 F.(2d) at 764)

Nevertheless the Circuit Court of Appeals apparently desired that some further findings should be made by the Commission with regard to the 50-year Mortgage Bonds. It is submitted that the full and complete findings and discussion of the Commission above referred to fully satisfy the requirements of the Consolidated Rock Products case and of all other applicable principles of law, and that no such additional findings are required in order to demonstrate the fairness and equity of the approved plan with regard to this issue.

(D) *Convertible Adjustment Mortgage Bonds.* These bonds, which the Commission found to be outstanding in the principal amount of $182,873,693, with accrued interest as of December 31, 1938 amounting to $79,550,055 (R. 2172), have a lien upon the property subject to the First and Refunding and 50-year Mortgages, junior to the lien of those two mortgages and all other mortgages prior thereto (R. 2172). As pointed out by the Commission (R. 2253) the total

system debt ahead of these bonds is approximately $364,000,000; and the annual charges on the principal thereof about $14,596,000; and on the total debt, including unpaid interest, about $17,000,000. The Commission further found with regard to this bond issue:

> "As compared with the above-stated charges on the debt ahead of the adjustment mortgage bonds, the system income available for interest, as adjusted by the committee, averaged $21,038,461 a year during nine predepression years 1921-29. During the succeeding nine years, 1930-38, the average was $9,571,180, and during the entire 18 years it was $15,304,822. In the discussion of stockholders' equity which follows we take the position that the peak earnings of one or two years in the past cannot be relied on as indicative of an earning power sufficient for a finding that the equity is of value. In the case of the adjustment mortgage bonds the situation is different in that the charges on all prior-lien debt were more than covered over a long period of time prior to the depression and are nearly equalled by the average earnings during the past 18 years, as well as by the earnings predicted for the future normal year. As compared with a debt of approximately $364,000,000 ahead of the adjustment mortgage bonds, the cost of reproduction of the system properties, less depreciation, plus the value of lands and rights, an allowance for working capital, and the net additions and betterments reported by the carriers in 1936 and 1937, was $662,759,838. We

consider that the issue of new common stock to the adjustment mortgage bondholders, as proposed by the committee, is justified, but not in the amount proposed. The plan we approve advances the position of the adjustment mortgage bonds over that of the committee's plan since the charges ahead of the new common stock will be reduced by some $1,635,000 below those shown in the committee's plan, on the basis of a $2,500,000 additions and betterments fund in each case.

"After the provision hereinafter made for the allotment of 35,625 shares of new common stock to the Gary bondholders, there remains for distribution to the adjustment-mortgage bondholders and to the unsecured creditors 1,804,492 shares of new common stock. We hereinafter set aside 55,000 shares of common stock as representing a fair proportion of the equity of the new company for the unmortgaged assets of the debtor. Thus there will remain 1,749,492 shares for distribution to the adjustment-mortgage bondholders for their claim upon the mortgaged assets of the debtor. Since the principal of this claim and interest to June 29, 1935, the date of filing of the petition, amount to $230,420,853, it is evident that the above allotment of stock, taken at $100 a share, will fail to satisfy the claim by $55,471,653. For this portion of their claim, these bondholders should be permitted to participate with other unsecured creditors in the free assets of the debtor. In view of the insufficiency of proceeds of mortgaged assets to meet the claims

> of the adjustment bondholders and the apparent inadequacy of the free assets to satisfy the deficiency, with interest, and the claims of unsecured creditors, with interest, we find that no allowance should be made in the plan for interest on these obligations for the period subsequent to the date of filing of the petition." (R. 2256-2257)

With respect to the claim of the Convertible Adjustment Bondholders against the Debtor's free assets the Commission concluded that there should be assigned "approximately 39,163 shares of common stock in addition to the 1,749,492 shares initially assigned. This additional assignment, in respect of the debtor's free assets, is on the basis of approximately 0.7 share to each $1,000 of claim, and the same basis should be followed in the treatment of all other unsecured claims allowed by the court. In the event a substantial part of the 55,000 shares remains unallotted after all the general claims are disclosed and dealt with, such remainder should be distributed pro rata among the holders of the adjustment mortgage bonds and the unsecured claims." (R. 2257)[24] This treatment of the Convertible Adjustment Bonds was again approved by the Commission in its supplemental report of June 4, 1940 (R. 1307-1308), and by the District Court, which stated that "The Commission allotted to them

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[24] The Commission's findings and conclusions with regard to the Debtor's free assets and the treatment of the unsecured creditors are discussed below, pp. 81-83.

out of the permissible capital structure all that was left after satisfying prior claims." (R. 1891) No discussion of the treatment of the Convertible Adjustment Bonds appears in the opinion of the Circuit Court of Appeals except a general statement that additional findings are required, immediately followed by the statement that "in our opinion there is evidence in the record to support the plan as proposed." (R. 2314) Here again it is submitted that all necessary findings have been made by the Commission in its full and complete consideration of this issue and its conclusions with respect to its proper treatment.

(E) *Milwaukee and Northern Railway Company First Mortgage Bonds.* "As hereinbefore shown," the Commission stated, "the first mortgage of the Northern, under which $2,117,000 of 4½ percent bonds, due June 1, 1939, are outstanding,[25] constitutes a first lien on about 110 miles of line, mostly south of Green Bay, Wis., and certain units of equipment. The report of our Bureau of Valuation shows, as of December 31, 1935, the cost of reproduction of this property, less depreciation, plus the value of lands and rights, as $4,284,286." (R. 2248)

The Commission then considered the evidence of record as to the earnings of the Milwaukee and Northern Railroad properties as a whole, including those subject to its First Mortgage and those subject to its

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[25] In addition to $38,000 principal amount pledged under the First and Refunding Mortgage.

Consolidated Mortgage discussed below (pp. 74-76), and the segregated earnings of the properties subject to the two mortgages, respectively. It pointed out that the analysis of the total earnings of the Milwaukee and Northern for the 12 months ended September 30, 1933, and the year 1934, showed income available for interest of $228,236 and $370,016, respectively, as compared with total interest charges of the Milwaukee and Northern amounting to $323,505. A statement for the year 1936 showed income of $495,182 available for interest from the Northern lines as a whole, and a breakdown of this statement indicated $411,633 as the available income of the Milwaukee and Northern First Mortgage lines. In the preparation of this statement the Milwaukee and Northern had been treated in some respects as a separate road, and in others as a part of the Debtor's system, and it was estimated that to place the computations for 1936 on a strictly system basis, the amount available for interest on its First Mortgage bonds should be reduced by approximately $125,000. The reduced figure of $286,633, the Commission found, would be approximately three times the interest charges of $95,265 on the Milwaukee and Northern First Mortgage Bonds (R. 2248-2249).

On the basis of this detailed consideration the Commission found:

> "From the evidence regarding the elements of value and earning power of the Northern first mortgage lines we conclude that the hold-

ers of the first mortgage bonds should be entitled to receive the new securities provided herein, viz., on the basis of new first mortgage 4 percent bonds equal to 70 percent and new general mortgage 4½ percent bonds, series A, equal to 30 percent of the total claim, including any interest unpaid." (R. 2249)

As stated by the District Court in approving the treatment of these bonds thus provided by the Commission, "It appears that in the light of the facts disclosed by the record and with the limited capitalization and fixed interest charges necessarily imposed by the Plan, the treatment received by these securities was all that they could reasonably expect and was, under the circumstances, fair and equitable." (R. 1886) No specific consideration is given to this issue by the Circuit Court of Appeals except its general request for additional findings coupled, as above noted, with the statement that "in our opinion there is evidence in the record to support the plan as proposed" (R. 2314).

(F) *Milwaukee and Northern Railroad Company Consolidated Mortgage Bonds.* The Milwaukee and Northern Consolidated Mortgage, under which $5,072,000 principal amount of bonds are outstanding (including $20,000 pledged under the First and Refunding Mortgage), is a first lien, as the Commission found, on approximately 268 miles of line north of Green Bay, Wisconsin, and a second lien on the lines south of that point upon which the Milwaukee and Northern First Mortgage, discussed above, is a first lien. (R. 2168)

The Commission's findings with respect to the earnings of the Milwaukee and Northern lines as a whole, referred to in connection with its First Mortgage, are equally applicable in considering the Consolidated Mortgage. Segregation of the 1936 earnings of the Milwaukee and Northern lines as a whole showed income available for interest of $83,549 as compared with $228,240 of interest requirements on its Consolidated Mortgage bonds. If the earnings of its First Mortgage properties in excess of the amount of the interest charges thereon, as indicated in these studies, were added to the earnings of the properties on which the Consolidated Mortgage is a first lien, the Commission pointed out, the interest on the latter bonds was earned in 1936 about 1.2 times (R. 2248-2249).

"Because of their first lien position and the earnings available for interest," the Commission found, "the general mortgage bonds and the Northern consolidated mortgage bonds take precedence over the other claims just mentioned above." (R. 2250)[26] After referring to the fact that the allocation of 1936 earnings showed the interest charges on the General Mortgage Bonds as being earned 1.16 times, the Commission continued:

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[26] The other claims referred to were the Debtor's 50-year Mortgage Bonds discussed above, pp. 61-68, the Debtor's Convertible Adjustment Mortgage Bonds discussed above, pp. 68-72, and the Gary First Mortgage Bonds discussed below, pp. 77-80.

"Thus on the basis of income available in 1936 for payment of interest, stated above, the Northern's consolidated mortgage bonds are on a parity with the general mortgage bonds. The cost of reproduction of the property with respect to which the Northern consolidated mortgage is a first lien, less depreciation, plus the value of lands and rights as of December 31, 1935, was $8,223,131, and the corresponding sum for the property subject to the first lien of the Northern's first mortgage and the second lien of the consolidated mortgage was $4,284,286.

"We conclude that the holders of the debtor's general mortgage bonds and the holders of the Northern's consolidated mortgage bonds should be accorded similar treatment under the plan, receiving the securities of the new company as provided herein, viz., each on the basis of new first mortgage bonds equal to 25 percent of the total claim, including unpaid interest, new general mortgage bonds, series A, equal to 35 percent, new general mortgage bonds, series B, equal to 20 percent, and new preferred stock of par value equal to 20 percent." (R. 2251)

The provision thus made for the Milwaukee and Northern Consolidated Mortgage Bonds was specifically approved by the District Court (R. 1885-1886; 36 F. Supp. at 210-211), and the Circuit Court of Appeals made no specific reference to this issue except its general request for additional findings above referred to (R. 2314). The Commission's findings above outlined, it is submitted, are full and adequate.

(G) *Chicago, Milwaukee and Gary Railroad Company First Mortgage Bonds.* In its original report the Commission found the bonds issued under the Gary First Mortgage to be $5,700,000 principal amount, including $3,000,000 principal amount in the hands of the public and $2,700,000 pledged under the First and Refunding Mortgage,[27] with accrued unpaid interest of $562,500 on the bonds publicly outstanding as of December 31, 1938. The mortgage is a first lien on 83 miles of line, more particularly described below, and certain other property (R. 2170).

The Commission's further original findings with respect to this issue were in part as follows:

> "During the period prior to 1930, when separate books were kept, the Gary failed to earn the $150,000 of interest on its guaranteed bonds in 1922, 1923, 1924, 1927, and 1928. The studies made for certain subsequent years show that the income available for interest was $142,000 in 1933, $60,000 in 1934, and $54,161 in 1936. But approximately 50 per cent of the total revenues in all these years represented Milwaukee traffic, largely coal, which could have been moved over the Milwaukee line via Bensenville and Kirkland. Withdrawing such revenues and substituting the estimated cost of moving the traffic via Bensenville, there would have been a deficit of $45,816 in the Gary's net income available for interest in 1936. Giving effect to the earnings of the other parts

[27] The stock of the Gary is also pledged under the First and Refunding Mortgage (R. 2171).

> of the system in connection with the Gary traffic, including that of the Rockford terminal, the debtor computed the net earnings in 1936 at $48,933. The Gary line, in effect, is cut in two by the trackage operation over the Elgin, Joliet & Eastern Railway, under a burdensome trackage agreement." (R. 2257-2258)

In the plan initially approved on the basis of this report the Commission, in view of the foregoing, allocated only common stock to the Gary bondholders. The proper allocation of new securities to this issue was the subject of very detailed further consideration by the Commission in its supplemental report of June 4, 1940. The Commission found in detail the facts as to the physical properties of the Gary and the provisions of the trackage agreement with the Elgin, Joliet & Eastern, found and discussed from various different standpoints the earnings of the Gary for specified periods, and the expense of moving the traffic by an alternate route, and referred also to the elements of physical value of the properties, including cost of reproduction less depreciation plus value of lands and rights, and valuation for rate making purposes. On the basis of these detailed findings the Commission reached the following conclusions with respect to the treatment of the Gary Mortgage bondholders:

> "It is apparent to us that the Gary property, split into three disconnected portions as it is, and so dependent upon the Elgin, Joliet & East-

ern, a competing line, for the much restricted trackage rights described, has very limited earning power as a railroad. The property and facilities at Rockford, however, are fairly productive of revenues not only for the Gary property as such but also for the debtor's system, as above indicated. Under all the circumstances we are of the opinion that the Gary bondholders should receive somewhat better treatment in the allocation of new securities than in the approved plan, and we accordingly find that the plan should be modified so as to allocate to the Gary bondholders 75 per cent of the principal of their claims, including accrued interest, in new preferred stock, on the basis of $100 par value of preferred stock for each $100 of claim, and the remainder thereof in new common stock on the basis of one share of common stock for each $100 of claim." (R. 1311)

Dealing with the provisions of the plan with regard to these bonds the District Court stated: "The Gary line has a record of poor earnings. * * * There is nothing in the record which would justify better treatment for this group." (R. 1890-1891) Speaking of the wiping out of this divisional mortgage in the new capital structure, the Circuit Court of Appeals stated "Simplification was thereby obtained, and we approve of that." (R. 2314) Nevertheless the court demanded additional findings with regard to the treatment of these bonds. It is submitted that the treatment by the Commission of the problem presented by the Gary

Mortgage Bonds, and its detailed findings and conclusions with respect thereto, are full and adequate and that no further findings can justifiably be required.

(H) *Bellingham Bay and British Columbia Railroad Company First Mortgage Bonds.* This mortgage, as the Commission found (R. 2172), is secured by a first lien on 67 miles of line in the State of Washington and on a small amount of equipment (R. 2172). All of the $301,000 principal amount of first mortgage 5 per cent bonds, due December 31, 1932, issued under this mortgage (R. 2172) are pledged with Reconstruction Finance Corporation as a part of the collateral for its loans to the Debtor. The report of the Commission's Bureau of Valuation on the elements of physical value of the Debtor's total properties and its various mortgage divisions, referred to by the Commission in its report (R. 2164), shows an original cost of the property subject to this mortgage of $2,120,273, a cost of reproduction less depreciation of $1,773,102, and a value of land and rights to be added to the latter figure of $289,356 (I.C.C. Bureau of Valuation Report, Sheet 1, included in unprinted record).

Since as above stated all the bonds issued under this mortgage are held by Reconstruction Finance Corporation as part of its collateral, no specific allocation of new securities was made in respect of these particular bonds, although they undoubtedly entered into the basis for the over-all finding of the Commission regarding Reconstruction Finance Corporation's claim "that the margin of security for these

loans is unusually large." (R. 2247) In view of the undoubted security of Reconstruction Finance Corporation's claim and of the relative insignificance of this $301,000 principal amount of bonds in determining the treatment of Reconstruction Finance Corporation's total claim of approximately $11,000,000, it is submitted that no additional findings with regard to the Bellingham Bay Bonds were necessary in order to enable the Commission and the Courts to pass upon the fairness and equity of the approved plan. Indeed, the Circuit Court of Appeals does not suggest that any specific additional findings are required, but mentions the Bellingham Bay Bonds simply in a general recital of issues with regard to which additional findings are stated to be necessary.

In view of the somewhat different issues raised by the findings and conclusions of the Commission regarding the treatment of the various Terre Haute mortgages, and of the Terre Haute lease and stock, these will be separately discussed in Point IV, pp. 83-104, below.

In addition to its allocations of new securities to the various mortgage creditors of the Debtor hereinabove discussed, the Commission also considered the status of the unsecured creditors of the Debtor as follows:

> "The only equity in the property which can be used as the basis of securities to satisfy the claims of general creditors is evidently confined to the value of the debtor's free assets.

> As far as the record shows such assets are represented by the Milwaukee Land Company, the stock and notes of which, the debtor contends, are of substantial value. The balance sheet of the land company, dated April 30, 1937, shows total assets of $9,021,896, including $3,354,250 for 'capitalized overhead on land and timber.' After deducting the latter item, the remaining assets would be $5,667,646. The company's income accounts for the five years 1932-36 show net deficits ranging between $331,956 in 1936 to $1,053,996 in 1934, with interest accruals slightly in excess of $600,000 a year. Considering the above indications of value we find that not exceeding 55,000 shares of new no-par-value common stock may be issued against the debtor's unpledged interest in the land company approximately on the basis of capitalization followed in establishing the new capital structure for the properties subject to mortgages." (R. 2260-2261)

As pointed out in discussing the provision made for the Debtor's Convertible Adjustment bondholders (p. 71, *supra*), the Commission also found that 39,163 shares out of the 55,000 shares of common stock should be allocated to the deficiency claims of the Convertible Adjustment bondholders at the rate of 0.7 share for each $1,000 of claim. It further provided (R. 2261) that the remaining 15,837 shares should be applied to the settlement of all other unsecured claims, as approved by the Court, at the same

rate. In the event that substantially all such remaining shares were not so applied the Commission found that the remainder should be distributed pro rata among the holders of the Convertible Adjustment Mortgage Bonds and the holders of unsecured claims (R. 2261). These provisions were briefly referred to by the District Court in its opinion approving the plan (R. 1891), but the Circuit Court of Appeals does not discuss the provisions of the plan with respect to the unsecured creditors or request any additional findings thereon.

IV

THE FINDINGS AND CONCLUSIONS OF THE COMMISSION WITH RESPECT TO THE TERRE HAUTE ARE ADEQUATE

"The Terre Haute mortgages, four in number of combined face values of $21,929,000," said the Circuit Court of Appeals in its opinion, "are a lien on the branch known as the Terre Haute lines, and as to the part this line and this mortgage play in the reorganization, the controversy is rich in intensity and fact conflicts. This mortgage existed before the railroad was acquired by the Debtor, and the report of the I.C.C. upon the value of these bonds and the circumstances under which the road was acquired, have given this transaction a malodorous reputation." (R. 2305; 124 F.(2d) at 761) The Circuit Court of Appeals held, however, that "It is quite impossible to approve of the disposition of the Terre Haute bond issues without having more specific findings." (R. 2314) It is there-

fore necessary to discuss in some detail the careful consideration given by the Commission to the Terre Haute problems, its full and complete findings and conclusions with respect thereto, and the exceedingly fair and equitable solution of these problems for which it provided in the approved plan.

The Terre Haute lines extend from Chicago Heights, Illinois, approximately 298 miles to Westport, Indiana, serving southern Indiana coal fields. Four mortgages are liens on all or a part of the properties, including (i) $350,000 principal amount of Bedford Belt Railway Company First Mortgage Bonds, of which $250,000 are outstanding in the hands of the public and $100,000 pledged under the Terre Haute First and Refunding Mortgage, (ii) $7,287,000 principal amount of Southern Indiana Railway Company First Mortgage Bonds, all of which are outstanding in the hands of the public, (iii) $9,573,000 principal amount of Chicago, Terre Haute and Southeastern Railway Company First and Refunding Mortgage Bonds, of which $8,056,000 are outstanding in the hands of the public, $1,515,000 pledged under the Debtor's First and Refunding Mortgage and $2,000 held in the treasury of the Terre Haute, and (iv) $6,500,000 principal amount of Chicago, Terre Haute and Southeastern Railway Company Income Mortgage Bonds, of which $6,336,000 principal amount are outstanding in the hands of the public and $164,000 held in the treasury of the Terre Haute. The specific terms of these respective bond issues and the liens of

the mortgages securing them, which need not be set out here, were found in detail by the Commission (R. 2163, 2169-2170).

As the Commission concluded after detailed study in the report referred to by the Circuit Court of Appeals, "That the Terre Haute", prior to its acquisition by the Debtor, "was a distress property there can be no question".[28] In 1921 the properties of the Terre Haute were leased to the Debtor for a 999 year term. The lease provides for the payment of a sum equal to the corporate expenses of the lessor not exceeding $12,000 a year, taxes, amounts owing by the lessor under leases and trackage agreements and an amount equal to the interest on the bonds outstanding, or subsequently issued by the lessor pursuant to the terms of the lease, against the Terre Haute property. It also provides for the payment by the lessor of maturing bonds of the Terre Haute, subject to reimbursement at the termination of the lease (I. C. C. Exhibit 75, included in unprinted record; R. 2163). The Debtor also owns 40,471 out of a total of 41,730 shares, or approximately 97 per cent of the capital stock of the Terre Haute. The capital stock is entitled to 41,730 votes, and the holders of the Terre Haute Income Mortgage Bonds, under the terms of that mortgage, are entitled to 63,630 votes (R. 2163).

In its original report the Commission stated the

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[28] *Investigation of Chicago, Milwaukee & St. Paul Railway Co.*, 131 I.C.C. 615, 657 (1928). See R. 1721.

cost of reproduction of the Terre Haute property less depreciation, plus the value of land and rights, all as shown by the report of the Commission's Bureau of Valuation filed in the proceedings, as being $20,680,114.[*] (R. 2212; I. C. C. Bureau of Valuation Report, included in unprinted record.) It also referred to the estimated cost of replacing the Terre Haute equipment vacancies under the terms of the various mortgages as aggregating as of December 31, 1937 the sum of $7,106,149 (R. 2212).

The Commission then discussed the earnings of the Terre Haute for 1936, pointing out that on the basis of allowing the Terre Haute tariff rates on coal and other material hauled for the Milwaukee and per diem charges on the basis of separate roads, but considering the Terre Haute otherwise as a part of the Debtor's system, the income of the Terre Haute available for interest amounted to $2,990,126. Conforming the treatment of the haul of company material and freight car hire to the basis of operation of the Terre Haute as a part of the Debtor's system, the first-mentioned figure was reduced to $2,040,187. The Commission also referred to the earnings of the Terre Haute for other years. Finally, the Commission found that "It may be safely concluded that the earning power of the Terre Haute is sufficient to cover all interest requirements, but this earning power is largely dependent on a continuation of the Milwaukee's coal traffic, together

[*] The bonded indebtedness of the Terre Haute, as shown above, is $23,444,000, of which $1,515,000 is held by the Debtor.

with the commercial coal traffic that accompanies it, and would be greatly diminished if such traffic ceased. The present arrangement is distinctly to the advantage of the Terre Haute." (R. 2213) [30]

After pointing out the great desirability of a consolidation of the properties of the Terre Haute with those of the Debtor, and accepting a jurisdictional contention of the Terre Haute interests that the fact that the Terre Haute is not a debtor in the proceedings rendered impossible provision in the plan for such consolidation (R. 2213-2214), the Commission continued:

> "The immediate accomplishment of a consolidation of these properties and the elimination of unnecessary corporate structures and intercompany arrangements, very appropriate at this time, is thus thwarted. However, the reorganization of the debtor on a sound basis must not be prevented on that account. Nor

[30] See R. 1518-1519, 1695. Both the 40 per cent of the Terre Haute traffic consisting of company coal for the Debtor and the large additional portion consisting of commercial coal have shown substantial declines in recent years (R. 1707-1708; Court Exhibits 19, 21, 23), which in the case of company coal may be accentuated through increased use of Diesel locomotives (R. 1513, 1516; Court Exhibit 3). Commercial coal traffic on the Terre Haute has been stimulated and in the case of various marginal mines enabled to continue by the Debtor's coal purchases, and at one time was further stimulated by the Debtor by practices which the Commission found to come "perilously near to granting undue concessions to a few large operators on the Terre Haute." See *Investigation of Chicago, Milwaukee & St. Paul Railway Co.*, 131 I.C.C. 615, 660 (1928).

must the capital structure of the new company be too heavily weighted by Terre Haute obligations.

"Due to the comparatively low income which the system can fairly be depended upon to earn for the payment of interest and for other corporate purposes in the future, the fixed-interest charges of the system must be reduced to a point that results in a substantial reduction of the principal amount of fixed-interest obligations. Income bonds and securities junior thereto must, to a large extent, replace existing fixed-interest bonds. If the $21,929,000 of Terre Haute bonds may not share in this replacement process and the plan requires their assumption in full, with their existing liens, it would mean that these $21,929,000 of bonds would constitute approximately 27 percent of the total amount of new fixed-interest bonds, exclusive of equipment obligations, which we find should be authorized in the reorganization. As stated, there are also outstanding general mortgage bonds of the debtor, the principal and accrued interest of which amount to approximately $156,000,000. These bonds are secured by a first lien upon approximately 6,000 miles of railway east of Mobridge, which constitute the heart of the system. The cost of reproduction, less depreciation, plus the value of lands and rights, of this so-called heart of the system was approximately $359,000,000, as stated in the report of our Bureau of Valuation, compared with $20,680,114 representing similar elements as to the

Terre Haute properties stated in the same report. It is apparent that if adequate recognition be given to the highly-secured claim of the Finance Corporation and to the claim of the Northern on its underlying first-mortgage bonds in the allotment of allowable fixed-interest bonds, the allotment of such fixed-interest bonds to the general mortgage bondholders could not be more than double the amount of the existing Terre Haute bonds, whereas the mileage represented by the general mortgage is about 18 times that of the Terre Haute, and on the basis of the elements of value just described for the lines covered by the general mortgage, about 17 times that of the Terre Haute properties. The problem is succinctly stated by counsel for the debtor in discussing the situation as to the Terre Haute securities in the event we should find that the fixed charges should be substantially less than $6,500,000. He said: 'It may be doubted whether the holders of senior liens upon the debtor's own 10,000 miles of property can be expected to consent to an arrangement which contemplates the continuance of the operation of the 10,000 miles, with no substantial return on their invested capital, merely to provide fuel consumption to support the payment of full fixed interest on the Terre Haute bonds, representing 300 miles.'

"Under the circumstances, we shall approve as part of the plan, provisions for dealing with the Terre Haute bonds in a manner which bears a fair and equitable relationship to the treat-

ment accorded the bondholders of the debtor, does not require a consolidation of the properties, and yet accords to the Terre Haute bondholders the same security under the existing mortgage, respectively, as their present bonds hold. However, these provisions, in order to become an effective part of the plan, will have to be accepted by substantially all of the Terre Haute bondholders." (R. 2214-2216).

The Commission then determined in detail (R. 2216-2218) the provisions to be contained in the approved plan. Under these provisions an offer is to be made to the holders of the four Terre Haute bond issues providing for (1) extension of all such bonds to January 1, 1989, the maturity date of the first mortgage Series A bonds of the new company; (2) all such bonds to bear fixed interest at the rate of 2.75% and additional interest of 1.5% contingent upon the earnings of the new company, or total interest of 4.25%; (3) equipment vacancies under the existing mortgages up to the effective date of the plan to be waived; (4) equipment subject to equipment trusts to be usable within stated limits in filling subsequent equipment vacancies, and (5) appropriate provisions to be included in the mortgages permitting, subject to the approval of the Commission, abandonment of portions of the Terre Haute lines.[31] These modifications would be embodied

[31] The operation of the 120 miles from Latta to Westport is unprofitable (I.C.C. Exhibit 77; Court Exhibit 17, both included in unprinted record). If this mileage were abandoned the bonded indebtedness of the Terre Haute (now $65,000 per mile) would be approximately $97,700 per mile.

in a new lease. If these proposals are not accepted by substantially all of the Terre Haute bondholders, the Terre Haute lease is to be rejected as of the date of determination by the court that such consent has not been given, without prejudice to the negotiation of a new lease or a consolidation of the properties of the Terre Haute with those of the new company, on terms subject to the approval of the Commission.

In its supplemental report of June 4, 1940 the Commission again explained in detail its findings and conclusions with respect to the problems of the Terre Haute, and the reasons therefor, stating:

> "Our conception of the position of the Terre Haute and its bondholders with respect to this proceeding and our jurisdiction are made clear in our prior report. We concluded that the desirable consolidation of the Terre Haute lines with those of the debtor, and the exchange of new system bonds for the existing Terre Haute bonds, were impracticable in connection with the plan because of the legal obstacle lying in the fact of the Terre Haute's outside status. Despite this fact the Terre Haute is in practical effect a part of the Milwaukee system, its bondholders are essentially system creditors, and a disruption of the lines would be to the disadvantage of both companies. We have been and remain strongly of the opinion that the plan should provide some means for retaining the Terre Haute lines as a part of the system without unduly jeopardizing a successful reorgan-

ization of the Milwaukee. In harmony with this idea we inserted in the plan the provisions outlined above, which were the best that we could devise in the public interest and as affording fair and equitable treatment to both the bondholders of the Terre Haute and those of the debtor. However, in order that the plan might be consummated on this basis, it was necessary to provide that substantially all the Terre Haute bondholders consent to the proposals, in contrast with the more-than-two-thirds majorities in the case of the several classes of Milwaukee creditors. It is doubtful that any plan could accomplish the desired ends if the Terre Haute bondholders, on jurisdictional grounds, are sufficiently opposed, but we still think that these bondholders should have the proposals presented to them and be afforded the opportunity to either accept or reject them.

"In the event of rejection there would seem to be no alternative but a rejection of the present lease, and the plan so provides. Such rejection is not intended as a threat. It is a necessary step in order that the processes of reorganization of the Milwaukee may not be thwarted. Without rejection of the lease the difficulties of effecting a reorganization, along the lines of the capital structure shown in the approved plan, are evident. The present interest charges on the Terre Haute bonds are approximately $1,023,000 a year. This exceeds the fixed interest requirements in respect of the modified Terre Haute bonds, under the ap-

proved plan, by about $420,000. Retaining the present fixed rental payments and at the same time keeping total fixed interest charges to about $4,270,000 a year, as provided in our plan, would thus necessitate reducing the amount of new first mortgage bonds issuable by $10,500,000. Such reduction would mean a substantial sacrifice by the creditors of the debtor who are to receive first-mortgage bonds in part settlement of their claims—a sacrifice in favor of the Terre Haute bondholders which, in our opinion, would be entirely inequitable. There would still remain unsettled the matter of the equipment vacancies on the Terre Haute. Under these circumstances we consider that there is no justification for the approval of a plan based upon the assumption by the new company of the lease, the guaranty of the Terre Haute income bonds, and the other obligations growing out of the lease. If the Terre Haute bondholders do not accept the proposals for modification of bonds, etc., a rejection of the lease clearly would be justified in order that the reorganization may proceed according to the plan.

"In the event the proposals be rejected, and the alternate provisions of the plan with respect to the Terre Haute become operative, all claims for damages growing out of the unfulfilled provisions of the rejected lease and the guaranty of the income bonds, in order to be recoverable at all against the debtor's estate, as we

understand the matter, would have to be filed with the court in this proceeding. It is also our understanding that such claims would have the status of general unsecured claims. Accordingly, the holders of such claims, to the extent allowed by the court, would participate with other general unsecured creditors in the distribution of such new securities as are provided and available under the plan." (R. 1302-1304)

The Commission thus considered fully the situation of the Terre Haute, and set out at length its findings and conclusions with respect to the proper treatment of the Terre Haute bonds and lease, and its reasons therefor. The offer to the Terre Haute bondholders provided for under the plan, it is submitted, is supported by fully adequate findings on the part of the Commission, and is clearly a fair and reasonable proposal. It was objected to before the Commission and in the Courts below by certain representatives of General Mortgage bondholders as too favorable to the Terre Haute, but as the Commission found, "the Terre Haute is in practical effect a part of the Milwaukee system, its bondholders are essentially system creditors, and a disruption of the lines would be to the disadvantage of both companies." (R. 1303) The objections of the Terre Haute bondholders, who contended that more favorable treatment should have been provided them, were of a more technical nature. In the event that the offer made is accepted by all or substantially all of the Terre Haute bondholders—which represents the only circumstance in which, under the plan, it would

become effective—no question from the standpoint of these bondholders arises. Accordingly, the objections of certain Terre Haute interests to these provisions of the Commission's plan have been devoted to the hypothetical alternative that the proposals are rejected by the Terre Haute bondholders. It has been argued that under these circumstances technical legal objections would prevent the rejection of the lease, which must therefore be unqualifiedly adopted by the reorganized company regardless of the Commission's conclusion that such adoption would render a reorganization almost impracticable.

According to the contentions made below, the legal doctrines involved are (a) that only a burdensome lease may properly be rejected and (b) that where a lease is rejected the rejection must relate back to the inception of the receivership or reorganization proceedings and cannot properly, as provided in the plan, be made effective as of the date the Court finds that the proposals made to the Terre Haute bondholders have been disapproved by them. It is not clear that the first contention can with propriety be argued by representatives of a lessor, particularly where the basic purpose is to avoid taking back the property claimed to be of such great value. Certainly, considering the entire dependency of the Terre Haute earnings upon the uncertain continuance of an already declining coal traffic, the obligations to be assumed on adoption and the necessities of a practicable reorganization plan, whether the Terre Haute lease should be regarded as

beneficial or burdensome presented an obvious question of business judgment on which the Commission was well justified in passing. *Mercantile Trust Co.* v. *Farmers' Loan & Trust Co.*, 81 Fed. 254 (C.C.A. 8th, 1897), *certiorari* denied 168 U.S. 710 (1897); *Park* v. *New York, L. E. & W. R. Co.*, 57 Fed. 799 (C.C.S.D. New York, 1893). Particularly is this true since we are dealing *not* with a rejection by a receiver or trustee, but with *a rejection under the plan*, and even expressed in terms of burdensomeness the problem is not whether the adoption of the lease would be beneficial to the reorganization estate but its effect on the operations of the reorganized company.[32]

In point of fact, it is submitted that the question of the provision to be made in a plan of reorganization under Section 77 for a lease under which the Debtor is lessee is in reality analogous not to adoption or rejection of leases by a receiver but to the willingness or unwillingness of a purchaser at a foreclosure sale to purchase this particular asset. The action of a prospective

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[32] The suggestion that rejection of the lease would deprive the reorganized company of surplus earnings of the Terre Haute over the amount required by the obligations of the lease, of course, assumes the continued existence of such earnings, which may be doubtful. See *supra*, pp. 86-87, particularly note 30. In addition, it ignores the ownership by the Debtor's estate of 97 per cent of the outstanding Terre Haute stock. Thus, for example, should the reorganized company after disaffirmance of the lease purchase its coal along the Terre Haute lines, paying tariff rates for its transportation, substantially all of any surplus earnings of the Terre Haute would be returned to the reorganized company in the form of dividends (R. 1522).

purchaser in this respect, and the provisions of a plan of reorganization in similar circumstances, may be controlled by numerous considerations other than "burdensomeness" in any immediate or technical sense.[33] Undoubtedly for this reason, Section 77(b) provides broadly without qualification that the plan of reorganization "may reject contracts of the debtor which are executory in whole or in part, including unexpired leases." And that a "rejection" under a plan may have different bases, as well as consequences, from a rejection by the bankruptcy trustee is also recognized by the further provision of the same subsection that a lease may be rejected by the plan *even though previously adopted by* the trustee.

With regard to the second contention above referred to, it is submitted that the doctrine of relation back of the rejection of a lease, in so far as material, is not an absolute rule, but an equitable principle the application of which may depend upon the equities of the particular case. *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 198 Fed. 721, 730(n) (C.C.A. 2d, 1912); *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 225 Fed. 734 (C.C.A. 2d, 1915); *Westinghouse Elec. & Mfg. Co.* v. *Brooklyn Rapid T. Co.*, 6 F. (2d) 547

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[33] Indeed, the foreclosure decree in an equity receivership proceeding frequently authorized the purchaser within a stated period after the sale to reject leases constituting part of the assets, without any distinction as to whether the lease was beneficial or burdensome. See for example *Guaranty Trust Co.* v. *Metropolitan St. Ry. Co.*, 177 Fed. 925, 929-930 (C.C.A. 2nd, 1910).

(C.C.A. 2d, 1925). The entire rental has been paid during the whole of the bankruptcy proceedings [34]; even had the lease been rejected the bankruptcy trustees had no choice but to continue operating the properties,[35] the Terre Haute being at all times admittedly unable to take over the operation for its own account; the Terre Haute earnings are substantially dependent on system operation; and the Debtor's estate itself, as the holder of 97% of the stock of the Terre Haute, is entitled to the Terre Haute properties except to the extent necessary to meet the claims of the bondholders under the lease. All these facts suggest considerations fully justifying the conclusion of the District Court upon the same contention that "In the light of the authorities and the facts above recited, the Court feels that it is clearly within the power of the Commission and the Court to so fix the effective date of disaffirmance. Furthermore, it would seem that the circumstances here present a case where the equities are such that the disaffirmance provided in the Plan

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[34] Under the lease (I.C.C. Exhibit 75, included in unprinted record) the rental consists of the interest on the Terre Haute bonds and the expense of maintaining its corporate existence, both of which have been regularly paid; and in addition payment has been made of the taxes on the Terre Haute properties. The payment of maturing Terre Haute bonds provided for under the lease does not involve rent but simply an advance to the Terre Haute repayable at the termination of the lease. Likewise the question of equipment vacancies concerns not rent but only a covenant to replace part of the original property used up during the lease.

[35] Sec. 77(c) (6).

should not relate back to the beginning of these proceedings even if the Plan itself had not expressly provided that the disaffirmance should become effective as of the date of the Court's finding that the Terre Haute bondholders disapproved the provisions submitted to them." (R. 1883; 36 F. Supp. at 209)

In addition, however, it is difficult to understand in what respect the Terre Haute or its bondholders are prejudiced by having the effective date of disaffirmance so fixed. So far as concerns the liability of the bankruptcy trustees for use and occupation, as above pointed out the full rent has been paid during the bankruptcy proceedings. And contrary to the contention of the Terre Haute interests that they would be entitled to any surplus earnings of the Terre Haute during bankruptcy, the law is well settled that the rent reserved under the lease (which, of course, continues to exist despite bankruptcy or a subsequent rejection by the Debtor's trustees) represents the maximum amount which the lessor is entitled to recover. *Sunflower Oil Company* v. *Wilson*, 142 U.S. 313, 322 (1892); *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 225 Fed. 734, 735-736 (C.C.A. 2d, 1915); *City and County of Denver* v. *Stenger*, 295 Fed. 809, 817-818 (C.C.A. 8th, 1924); *Oscar Heineman Corporation* v. *Nat Levy & Co.*, 6 F. (2d) 970, 973 (C.C.A. 2d, 1925); *In re United Cigar Stores Co. of America*, 69 F. (2d) 513, 516-517 (C.C.A. 2d; 1934), *certiorari* denied *sub nom. Reisenwebers, Inc.* v. *Irving Trust Co.*, 293 U.S. 566 (1934). The law is specifically so stated in Fin-

letter, *The Law of Bankruptcy Reorganization* (1939) 229-231; 2 Gerdes, *Corporate Reorganizations* (1936), §697; Clark, Foley and Shaw, *Adoption and Rejection of Contracts and Leases by Receivers*, 46 Harv. L. Rev. 1111, 1134-1135 (1933). So far as the possibility of a general unsecured claim for damages against the Debtor for breach of the lease is concerned, it is to be noted that such a claim would be wholly inconsistent with the alleged high earning power of the Terre Haute over the lease rentals, for the damages, if any, could only be the amount by which the rental exceeded the Terre Haute's future earning power. Furthermore, since the rental has been paid to date and will under the Commission's plan continue to be paid until the date of disaffirmance, it would appear that no damage could be involved to the Terre Haute in this respect prior to the date of disaffirmance.[86]

As the District Court cogently observed, "after all, the Commission and the Court are faced with the duty of passing upon the reasonableness and fairness of a plan from the standpoint of all parties in interest and the public, and while they may not have jurisdiction to deal directly with the interests of the Terre Haute bondholders, they do have not only the right, but the duty, in the formulation of such plan, to deal with the property of the Debtor, including its rights as lessee,

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[86] As to the equipment vacancies, the breach date would be neither the date of disaffirmance nor the date of the inception of the bankruptcy proceedings, but the date, as to the original breach long prior to the bankruptcy proceedings, on which the actual default occurred.

or otherwise." (R. 878; 36 F. Supp. at 207) Discussing in detail the situation of the Terre Haute and the objections there raised, which were the same as those above mentioned, to the treatment of the Terre Haute interests in the plan, the District Court stated:

> "* * * When this is considered in the light of the fact that the profitable character of the Terre Haute is dependent upon the continued operation of the rest of the system, it would seem neither to be unfair nor unreasonable nor inequitable that the Terre Haute bondholders be requested to make some sacrifice in order to maintain the continued operation of both properties upon a basis reasonably assured by prospective earnings. * * * The Commission had only so much cloth with which to make a suit. It would hardly have been justified in using so much of the material to make the vest that enough would not be left to provide a coat and trousers.
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> "The Terre Haute interests have suggested that the proposal of the Plan is in the nature of a threat. This hardly seems fair to the Commission which has frankly and fully stated the facts making it necessary to follow the course which was followed in preparing the Plan. The Commission was faced with a difficult problem. It adopted this course, as stated in its Supplemental Report, as a 'necessary step in order that the processes of the reorganization of the Milwaukee may not be thwarted.'
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> * * * *
>
> "The Court feels that the Commission, in dealing with the Terre Haute interests, handled

> a difficult situation in a very creditable manner and evolved a Plan which is fair and equitable, all things considered." (R. 1880-1881, 1885; 36 F. Supp. at 207, 208)

In considering the opinion of the Circuit Court of Appeals, it is important to note exactly what were the views of that court with respect to the Terre Haute. As has been noted, at the outset of its discussion the Circuit Court of Appeals observes that "the report of the I.C.C. upon the value of these bonds and the circumstances under which the road was acquired, have given this transaction a malodorous reputation." (R. 2305) Later in its opinion the Court states that "a management with ethics which would tolerate the Terre Haute transaction was sure, sooner or later to be applying to a court of equity or court of bankruptcy for protection against the hordes of insistent claimants with past due unpaid obligations." (R. 2311) After referring generally to its requirement of more findings, the Circuit Court of Appeals states finally that:

> "It is quite impossible to approve of the disposition of the Terre Haute bond issues without having more specific findings. *Whether this lease should not be now terminated* presents a separate question, which can only be determined when findings are made." (R. 2314; 124 F.(2d) at 765; italics supplied)

Obviously, therefore, the concern of the Circuit Court of Appeals was not with the contention, so violently urged upon it and upon the District Court,

whether the Terre Haute interests should have received better treatment than provided for in the Commission's plan. Its concern was "whether this lease should not be now terminated," i.e. rejected, and the Terre Haute bondholders left to their rights in the Terre Haute properties and such claims against the Debtor or its estate as might arise from the termination of the lease.

The Circuit Court of Appeals does not specify what additional findings it requires with respect to the Terre Haute, and it is submitted that the foregoing discussion makes clear that the Commission's reports contained complete findings and conclusions with regard to the Terre Haute, and a thorough consideration of the problems involved. The Commission's plan provides for a fair and reasonable offer to the Terre Haute bondholders, to become effective on acceptance by substantially all of such bondholders, and if the bondholders are given an opportunity to vote thereon it is entirely possible and indeed probable that the proposal made will be accepted by them. In such event the alternative remedy of disaffirmance, though necessarily provided as a contingency in the plan, would never become effective. Even should such a necessity arise the provisions with respect to the rejection of the Terre Haute lease or, more exactly, the refusal of the reorganized company to accept it as part of the properties to be acquired under the plan, are fully valid and within the powers of the Commission and the District Court. Accordingly, it is submitted, the provisions of the plan

of reorganization with regard to the Terre Haute lease and the claims of the Terre Haute bondholders are based on fully adequate findings and conclusions by the Commission, are entirely reasonable and proper, and should be approved.

V

UPON THE ENTIRE RECORD THIS COURT SHOULD REVERSE THE DECREES OF THE CIRCUIT COURT OF APPEALS AND AFFIRM THE DECREE OF THE DISTRICT COURT APPROVING THE PLAN

On June 29, 1935, the Debtor, whose prior reorganization had been completed only in 1928, again invoked the shelter of the Federal courts. "There," to adopt the caustic brevity of this Court in *Palmer* v. *Massachusetts*, 308 U.S. 79, 82 (1939), "it has since remained." In accordance with the provisions of Section 77 the Interstate Commerce Commission, the administrative body experienced in the field and delegated for this purpose by Congress, held numerous hearings on the reorganization of the Debtor. In these hearings the full record hereinbefore described was developed, including all requisite valuation data and all other information necessary for the reorganization of the Debtor.

Upon the basis of this complete record, and after hearing all of the parties, the Commission developed a plan of reorganization for the Debtor which, as slightly modified after again hearing all of the parties on petitions for modification, became the plan of reorganiza-

tion approved by the Commission and certified to the District Court, and now under consideration here. This plan the Commission found to be compatible with the public interest, fair and equitable, and in all respects in accordance with the provisions of Section 77. In the District Court further evidence was taken and all parties again heard both on brief and in oral argument, and the District Court thereafter likewise approved the plan and declared its provisions to be fair and equitable and in all respects in accordance with law.

The Circuit Court of Appeals, as has been pointed out, had no doubt that the plan was supported by the record, and with respect to most of its substantive provisions specifically indicated its approval, requiring only that additional formal findings of a character not clearly specified should be made. These findings the Circuit Court of Appeals itself characterized in its subsequent decision with respect to the Chicago and North Western reorganization as involving neither jurisdictional nor property right objections, but as purely procedural.

That the Commission in its reports and orders stated fully its conclusions and the reasons therefor in accordance with the statutory requirement, and made all necessary findings and conclusions, has been hereinbefore fully established. Under these circumstances, and in view of the full and complete record which the Circuit Court of Appeals itself concedes supports the plan and of the length of time for which these proceedings have already dragged on, we urge the Court

in the public interest and in the interest of the conclusion of these long drawn out proceedings not to remand the case to the Circuit Court of Appeals for further action but to dispose finally and conclusively of the problems involved.[37]

As hereinbefore pointed out (pp. 36-37 above) the same general principles and procedure followed by the Commission in this case have been followed by it in numerous other reorganizations under Section 77 now pending either before the Commission or the Courts, and the aggregate principal amount of the outstanding loans of Reconstruction Finance Corporation itself to railroads or their trustees in cases where the plans of reorganization may be affected by the decision in the present case exceeds $125,000,000. In order that the parties in these various proceedings, as well as the Commission and the Courts, may be advised of the proper principles and procedure to be followed in reorganizations under Section 77, it is respectfully requested that the Court in its decision in the present case clear away the misconceptions which have arisen about the decision in the Consolidated Rock Products case and indicate practicable principles and procedure to be followed in railroad reorganizations on the matters here involved.

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[37] The jurisdiction of this Court to make such final disposition, notwithstanding the apparent failure of the Circuit Court of Appeals to pass definitively upon the merits of the controversies involved, is unquestionable. *Story Parchment Co.* v. *Paterson Parchment Paper Co.*, 282 U. S. 555, 567-568 (1931); *Cole* v. *Ralph*, 252 U.S. 286, 290 (1920).

CONCLUSION

It is submitted that the decrees of the Circuit Court of Appeals for the Seventh Circuit should be reversed, and that the decree of the District Court should be affirmed.

Respectfully submitted,

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SEPTEMBER, 1942

APPENDIX A

The provisions of Section 77 (11 U.S.C., Section 205), as amended, pertinent in this case are the following:

(a) Any railroad corporation may file a petition stating that it is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization. The petition shall be filed with the court in whose territorial jurisdiction such corporation, during the preceding six months or the greater portion thereof, has had its principal executive or operating office, and a copy of the petition shall at the same time be filed with the Interstate Commerce Commission (hereinafter called the "Commission"):

* * * *

(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stockholders generally, or of any class of them, either through the issuance of new securities of any character, or otherwise; (3) may include, for the purpose of preserving such interests of creditors and stockholders as are not otherwise provided for, provisions for the issuance to any such creditor or stockholder of options or warrants to receive, or to subscribe for, securities of the reorganized company in

such amounts and upon such terms and conditions as may be set forth in the plan; (4) shall provide for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; (5) shall provide adequate means for the execution of the plan, which may include the transfer of any interest in or control of all or any part of the property of the debtor to another corporation or corporations, the merger or consolidation of the debtor with another corporation or corporations, the retention of all or any part of the property by the debtor, the sale of all or any part of the property of the debtor either subject to or free from any lien at not less than a fair upset price, the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein, the satisfaction or modification of any liens, indentures, or other similar interests, the curing or waiver of defaults, the extension of maturity dates of outstanding securities, the reduction in principal and/or rate of interest and alteration of other terms of such securities, the amendment of the charter of the debtor, and/or the issuance of securities of either the debtor or any such other corporation or corporations for cash, or in exchange for existing securities,

or in satisfaction of claims or rights or for other appropriate purposes; and may deal with all or any part of the property of the debtor; may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section.

* * * *

(c) After approving the petition:

* * * *

(10) The judge may direct the debtor or the trustee or trustees to keep such records and accounts, in addition to the accounts prescribed by the Commission, as will permit of such a segregation and allocation, as the necessities of the case may require, of the earnings and expenses between and to the divisions and parts of the railroad or other property of the debtor which are separately subject to the liens of the various mortgages or deeds of trust, or are separately subject to lease, and may refer to the Commission for its recommendations after hearings thereon if the parties shall so request and/or the Commission determine necessary or desirable, as to the method or formula by which such segregation and allocation shall be made; and thereafter such segregation and allocation may be made at the expense of the debtor's estate.

(11) The Commission may direct such of its agencies as it may designate to file in the proceedings before the Commission a report, and additional or supplemental reports at such time or times as the Commission

shall designate, of such data with reference to the property, business, earnings, and corporate organization of the debtor and such other facts as the Commission, after hearing if it deems necessary shall determine to be necessary or helpful information for the purposes of the preparation of reorganization plans, and for the purpose of aiding in determining the method or formula of allocating earnings permitted by subdivision (10) of this subsection (c). Such report or reports shall be prima facie evidence of the facts therein stated in any proceeding under this section. The actual cost of preparing said report or reports shall be certified by the Commission and shall be borne by the debtor's estate.

* * * * *

(d) The debtor, after a petition is filed as provided in subsection (a) of this section, shall file a plan of reorganization within six months of the entry of the order by the judge approving the petition as properly filed, or if heretofore approved, then within six months of August 27, 1935, and not thereafter unless such time is extended by the judge from time to time for cause shown, no single extension at any one time to be for more than six months. Such plan shall also be filed with the Commission at the same time. Such plans may likewise be filed at any time before, or with the consent of the Commission during, the hearings hereinafter provided for, by the trustee or trustees, or by or on behalf of the creditors being not less than 10 per centum in amount of any class of creditors, or by

or on behalf of any class of stockholders being not less than 10 per centum in amount of any such class, or with the consent of the Commission by any party in interest. After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall, after due notice to all stockholders and creditors given in such manner as it shall determine, hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be compatible with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

The Commission may thereafter, upon petition for good cause shown filed within sixty days of the date of its order, and upon further hearings if the Commission shall deem necessary, in a supplemental report and order modify any plan which it has approved, stating the reasons for such modification. The Commission, if it approves a plan, shall thereupon certify the plan to the court together with a transcript of the proceedings before it and a copy of the report and order approving the plan. No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall first have been approved by the Commission and certified to the court.

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(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of

all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of subsection (d) of this section. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon

or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: *Provided*, That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: *Provided further*, That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation)

the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the President of the United States, or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: *Provided*, That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the

light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e): *Provided further*, That if, in any reorganization proceeding under this section, the United States is a creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against, the debtor, as creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance, certified to the court, of a lesser amount by the President of the United States or the officer or agency designated by him pursuant to the provisions of the preceding paragraph hereof: *Provided further*, That if the President of the United States or such officer or agency shall fail to accept or reject such lesser amount for more than ninety days after receipt of written notice so to do from the court, accompanied by a certified copy of the plan, the consent of the United States insofar as its claims for taxes or customs duties are concerned shall be conclusively presumed. If the judge shall confirm the plan, he shall enter an order and file an opinion with a statement of his conclusions and his reasons therefor. If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commis-

sion for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission, the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder.

If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts.

(f) Upon confirmation by the judge, the provisions of the plan and of the order of confirmation shall, subject to the right of judicial review, be binding upon the debtor, all stockholders thereof, including those who have not, as well as those who have, accepted it, and all creditors secured or unsecured, whether or not adversely affected by the plan, and whether or not their claims shall have been filed, and, if filed, whether or not approved, including creditors who have not, as well as

those who have, accepted it. Upon confirmation of the plan, the debtor and any other corporation or corporations organized or to be organized for the purpose of carrying out the plan, shall have full power and authority to, and shall put into effect and carry out the plan and the orders of the judge relative thereto, under and subject to the supervision and the control of the judge, the laws of any State or the decision or order of any State authority to the contrary notwithstanding. The property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or retention, and the judge may require the trustee or trustees appointed hereunder, the debtor, any mortgagee, the trustee of any obligation of the debtor, and all other proper and necessary parties, to make any such transfer or conveyance, and may require the debtor to join in any such transfer or conveyance made by the trustee or trustees. Upon the termination of the proceedings a final decree shall be entered discharging the trustee or trustees, and making such provisions as may be equitable, by way of injunction or otherwise, and closing the case. Upon confirmation of a plan the Commission shall, without further pro-

ceedings, grant authority for the issue of any securities, assumption of obligations, transfer of any property, sale, consolidation or merger of the debtor's property, or pooling of traffic, to the extent contemplated by the plan and not inconsistent with the provisions and purposes of chapter 1 of Title 49 as on August 27, 1935, or thereafter amended.

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(g) If in the light of all the existing circumstances there is undue delay in a reasonably expeditious reorganization of the debtor, the judge, in his discretion, shall, on motion of any party in interest or on his own motion, after hearing and after consideration of the recommendation of the Commission, dismiss the proceedings. Upon the filing of such an order of dismissal, all right, title, or interest of the trustee or trustees shall vest by operation of law in the debtor unless otherwise provided by such order.

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(q) The provisions of section 12 of Title 49 shall be applicable to enable the Commission to perform its duties under this section and the provisions of such section shall apply to the debtor, any subsidiary or affiliated company, or any other person as herein defined.

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March 3, 1933, c. 204, § 1, 47 Stat. 1474; August 27, 1935, c. 774, 49 Stat. 911; June 26, 1936, c. 833, 49 Stat. 1969; August 11, 1939, c. 689, 53 Stat. 1406.